



# A strategy to overcome the effect of economic recession on construction industry in Oman

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Construction industry firms are affected by the financial fluctuations in the local and international markets. World countries have been exposed to many financial recessions such as the 2008 recession and the sharp decline in oil prices since 2014, which caused a major financial recession in countries that depend heavily on oil income in their economy like the Sultanate of Oman, where they constitute 70% of the national income. The research objective is to review previous literature review of some countries that have been exposed to economic recessions and how did these countries acclimatization to the recession. It will also focus on the strategies that followed by these countries to get out from the recession. Then, the research will identify the effects of the recession in the construction industry and the impact of it to the contractor in the Sultanate of Oman. Finally, a strategy will be suggested for the construction industry firm to use it through the economic recession to survive. The research methodology relies mainly on information provided by the Government of Oman through the National Center for Statistics and Information and through interviews with various construction specialists. The results show that most of the construction industry firms have been subjected to a great pressure due to the economic recession. The suggested strategy includes a procedure that assists construction firms to reduce expenses, how to bid and get new projects and create a new management style for the firm to cope with the developments and the volatility of the financial market.

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## Introduction

The construction industry is one of the most important sectors that play an active role in the development of the countries' infrastructure in the world. It is fully linked to the countries' national economy and any change in the countries' economic output can have a direct impact on the construction industry. Therefore, the impact of this change that firms within the industry must adapt significantly to the changing in the economic climate.

World countries have been subjected to many economic recessions during the nineteenth and twentieth century, the closest one began in the of mid-2008 in the United States of America and then have influenced the rest of the economic world. In addition, countries like the Sultanate of Oman have been influenced by the 2008 USA recession. Another economic recession was in 2014 which include the reduction of oil crude price which has led to a deficit in the state budget and continues to 2019 for about 3 billion dollars in 2018 (Ministry of Finance, 2019).

This research is aimed to assess the impact of economic recession in the construction industry in the Sultanate of Oman and then it will suggest a strategy for the firms on how they can survive during the recession.

World countries have faced many economic recessions, such as the recessions of 1929, 1997 and 2008 recession. Some countries like Sultanate of Oman became able to managed their economy in light of the global recession and it has reduced the budget deficit from 680.3 million Rials to 48.8 million Rials on 2010, but after the recession of 2008, which happened that once the recessions



started to fade, oil prices collapsed in 2014 due to oversupply and many countries like the Sultanate of Oman rely almost entirely on their budget on oil prices, resulting in a budget deficit . The Oman budget deficit in 2015 was 4631.4 million riyals compared to 1064.3 million riyals 2016 ((Ministry of Finance statics report, 2016). This indicates the huge impact of the decline in the economy of the Sultanate of Oman.

The Sultanate of Oman has reduced spending on various sectors such as the construction industry, which is the mainstay of infrastructure development. This decline has affected many construction firms that are working in the infrastructure field such as roads, buildings, bridges and dams.

Many firms, such as a Gulfar Construction Company and small firms registered with Small to Medium Enterprises (SMEs), suffered a difficulty in continuity due to shortage in projects offered by the government or the private sector and delayed the payment of their dues for the current project from the government or Client. This has resulted in accumulated profits, losses and delays in the payment of its obligations such as employees' salaries. Many government projects related to the construction industry have been blocked or delayed due to lack of funds such as the vital road linking Adam to Salalah. In addition, foreign investment projects such as The Wave Muscat and Integrated Village in Muscat have been canceled due to the effects of the financial recession to the investors. So, Oman government should address the current situation and make a future plan that enables construction industry firms to rectify their situation by facilitating investment in the construction industry.

Therefore, to avoid these fluctuations in the local markets, this research will go through previous literature review of some countries that have been exposed to economic recessions and how did these countries acclimatization to the recession. It will also study some strategies that followed by these countries to overcome the recession. Then, the research will focus on the effects of the recession in the construction industry and the impact of it to the contractor in the Sultanate of Oman. Finally, a strategy will be suggested to help the construction industry to overcome the negative factors of economic recession.

## **Effects of global economic recession on the construction industry**

Looking forward to the historical evidenced of economic recession it does not give a sufficient picture to keep the global economic in a greater moderation. Researchers like Laeven and Valencia (2008) indicate the following which show some factors happened between 1970 to 2008 that lead to such these financial recessions that are faced by the world nowadays:

1. 124 International bank interface of banking crises.
2. 208 Currency crises of different countries.
3. 63 countries could not repay sovereign debt.
4. 42 countries occur under 42 twin crises and 10 countries under triple crises.
5. A lot of countries rely on oil prices in their national economy, which are often volatile and unstable. An example of crude oil prices fluctuate is shown in Graph 2 below where price is oscillating under 20 USD per barrel to more than 140 USD per barrel.

**Figure 1.** oil crude prices from Dec 1993 to Dec 2015

In the twentieth century, the first economic recession was started in United State of America at the third quarter of 2008 which later on affected most of the world countries. This recession stages can be summarized as follows:



1. The US real estate market boomed between 2001 and 2006, encouraging banks and lending companies to resort to high-risk mortgages without granting loans, adequate collateral and with high risk for a higher interest rate and the goal is to maximize profits for lenders.
2. Interest rate rising, which led to a change in the nature of the US market represented in the decline in house cost, increasing number of defaulters in their mortgages in the United States, prompting lenders to take over real estate and the frequent confrontations between borrowers and banks.
3. The traditional financial and banking system based on a system of debt-scheduling at a higher interest rate, or the replacement of a repayment loan with a new loan at a high interest rate, which doubles the burden on the borrower.
4. The ability of banks to finance firms and individuals has been weakened leading to a reduction in the investment and consumer spending which threatened the recession.

These were the main causes of the economic recession in the United States, which is leading to:

1. Withdrawal of deposits from banks.
2. Many financial institutions freeze loans to companies and individuals for fear of being difficult to recover.
3. Lack of liquidity in individuals, companies and financial institutions, which led to a sharp contraction in economic activity and in all aspects of life.
4. Low level of energy utilized in companies due to lack of liquidity and freezing access to loans from financial institutions, except at a very high interest rate and collateral.
5. Decline in sales, especially in real estate, cars and others due to poor liquidity.

The US financial recession has reflected on most of the world's economies and has become dubbed the global financial recession. As Arab countries are part of the global economic system, they adversely affected by this recession. The extent of the impact of the Arab countries depends on the size of economic and financial relations between the Arab countries and the outside world. This research will focus on the impact of this recession on the Sultanate of Oman and in particular the construction sector.

The financial recession has direct and indirect effects on the economy of Oman. This is because the economy depends mainly on the main source of oil, any decline in prices or the volume of demand for it will have repercussions on economic growth and on the implementation of development plans and projects. This will certainly have an impact on the volume of its exports and on its trade balance. It will also have an indirect impact on the cost of commodity imports because the countries of origin are affected by varying levels of this recession, which makes them to reduce the volume of commodity production and thus increase demand and high prices or maintain the volume of production with increasing cost and price increase which will result in a slowdown in this situation.

The weakness of the global economy caused by the financial recession led to a decline in demand for oil, where prices fell to nearly (50) dollars a barrel after reaching the highest levels in more than (140) dollars a barrel earlier in 2008. There will certainly be a decline in Oman's cash flow rate as shown in graph 2 below.

**Figure 2.** oil, crude price from February to September 2009 (Ministry of Gas and Power statistics 2009)

## **Sultanate of Oman economy during the economic recession**

There is no doubt that Oman was within the scope of the economic recession that struck the United States in the mid-2008, followed by a decline in oil prices in 2014 and prices remain below



expectations until September 2019.

The financial statement for the 2019 budget issued by the Ministry of Finance in the Sultanate of Oman to optimistic estimates of the performance of the country's economy during 2019, where the estimated growth rate of GDP is about 3%. The estimate is completely different from the World Bank in its latest report issued in June 2019, where the report expects the growth rate of output in the Sultanate to decline to 1.2% in 2019, compared to 2.1% in 2018.

The Sultanate of Oman has announced a five-year diversification plan from 2015-2020 to reduce the dependence on oil revenues by half as a result of falling of oil crude prices to reduce pressure on the country's public finances.

Table 1 shows the impact of oil crude prices on the general budget of the Sultanate. It demonstrates the average oil prices in the Sultanate of Oman, which should not fall below the estimate average price. This is vital important to do not cause a general budget deficit. For example, in 2015, the budget deficit stands at RO 4,631.4 million with an average price of \$ 50.4 per barrel, while oil prices have crossed the barrier below \$ 40 per barrel, causing a huge deficit in the state budget. This has a negative impact on the public spending of the Oman Government in the infrastructure sectors, which is turning to reduce the work offered to construction industry firms.

(Deficit) / surplus	Price of a barrel per USA \$ of oil according to the general budget	Year
116.4	27.63	2003
230.3	33.91	2004
302.9	48.73	2005
43.8	61.3	2006
40.2	63.55	2007
78.4	101.78	2008
(680.3)	56.3	2009
(48.8)	76.04	2010
(113.2)	100.92	2011
(80.6)	109.29	2012
(82.6)	105.67	2013
(1064.3)	103.2	2014
(4631.4)	50.4	2015

**Table 1.** Income and expenditure for the general budget between 2003 and 2015

In addition, it is noted that according to the statistics of the Ministry of Oil and Gas, the rate of daily crude oil production has increased rapidly since the beginning of the financial recession to reduce the pressure in the national budget. For example, the daily production in 2008 was 757,000 barrels per day has increased to 918,500 barrels per day in 2012.

## **Omanis construction industry firms suffer with economic recessions**

The contracting sector is one of the largest and dynamic sectors in the Sultanate of Oman as the number of firms working in it according to the data registered in the Ministry of Commerce and Industry, 2019 about 100 thousand companies with 57 thousand Omani workers and around 700 thousand foreigners.

Graph 3 below shows the number of contracting firms registered in the General Authority for Small and Medium Enterprises (National center for static & information, 2019) where these data show



the number of construction firms registered in 2019 decreased by 82.64% compared to the first quarter of 2016. This is because of the impact of the Sultanate's of Oman economic recession due to the deterioration of oil prices. Accordingly, the number of projects awarded by the government decreased and lots of existing projects were stopped or delayed.

**Figure 3.** *small and medium enterprise*

The repercussions of the global financial recession showed a strong need for a strategy for the construction firms to overcome from the economic recession.

An example of the construction firm breakdown in the world during an economic recession is Carillion Construction firm. Its breakdown after the creditors refused to provide them with more financial support (as shown in graph 4 below) which led to a forced liquidation.

**Figure 4.** *average net borrowing*

Carillion worked in different countries through the world included Sultanate of Oman. It constructs a different infrastructure like hospitals and hotels. After 2008, Debts started to accumulate on the firm due to the delay in receiving financial dues and high financial banks such as salaries of employees forced the company to reduce its business in the world and withdraw from several countries such as Oman, UAE and Qatar try to reschedule the company for recovery again, but these procedures increased the firm complexity and increased the debt until it reached more the 100% of the income and firm value. Then they tried to borrow from banks, but the banks refused to lend it since they don't have any guaranty, they can pay the loan and return firm in a better situation.

Another Omani construction firm suffers from the economic recession is Gulfar. Since 2008 till 2018 Gulfar made loses and profit less than expectation. Table 6 below shows an example of Gulfar net profit the impact of economic recession on it.

**Figure 5.** *Gulfar financial statement (Capital Market Authority, Sultanate of Oman 2019)*

Therefore, the Gulfar has sought to correct the Company's path and minimize losses, such as:

1. Open new construction firms in Kuwait on April, 2018 under name Gulfar Construction and Contractor to invest in the building, road and oil sector.
2. Sell all its existing projects and assets in India to MP *International L.L.C.*
3. Claim all dues from the government and private sectors which are estimated more than 224 million Omani Rial (conference held at the Capital Market Authority in 9, April 2019)

This is an example of Gulfar reflection of the economic recession in Sultanate of Oman. In general, it achieved losses, but in turn maintained its basic elements in terms of staying in the work with minimal losses and keeping employees from layoffs.

## **Strategic options to minimize the effects of the economic crisis on the construction sector in Oman**

Small and large construction industry firms have almost the same obligations like employment, salaries, administrative expenses, shareholders' profits... etc., so firms operation have to be



adjusted during the recession to be able to run without losses. The Construction firms' respond to the economic recession is summarized into two sections:

## **1.0 Contracting procedures**

Contract procedures are those methods adopted by contractors in seeking every possible way to get work to maintain their rotation. Here is a list of different factors that assist construction firms to get a chance to enter a competition for new projects during the recessions:

1. Bidding for a different project that fall within the firm's capabilities and resources.
2. Set up a limit size for any project so if there is any failure in a single project does not jeopardize the firm's business and operation.
3. Enter into a futures contract with subcontractors and suppliers to protect the firms against escalating cost.
4. Bid for a project with small or zero profit margins or below cost.
5. Diversification in other construction-related work.
6. Implement a fast track and short-term projects.
7. Establish a joint venture with other contractors.
8. Take subcontract work from contractors.
9. Establish a Venture into foreign markets.
10. Form a partnership with customers.
11. Obtain projects from expired firms.
12. Adoption of acquisitions and mergers
13. Diversification in various non-construction works

## **2.0 Cost control procedures**

Cost control in the construction industry is a primary factor to overcome loses during the recession. Construction firms have to control the cost in line with the current recession. This list suggests some effective approaches to control cost:

Applying more rigorous site management will work effectively to minimize waste of materials. It could be done by hiring a site management staff to minimize waste material such as:

1. Customer mistakes.
2. Purchased products that do not match specifications.
3. Control at site the main causes of material waste timber, cement / mortar, concrete and blocks are the four main materials with a high level of waste on construction sites.

Appropriate storage, handling, reuse and recycling practices minimize site losses. Reducing waste of materials will improve project performance, enhance value for individual customers and have a positive impact on the firm cash flow.

Apply more stringent financial management of the firm's cash flow.

These can be applied by following these factors:

1. Specify a break point.
2. To concentrate on cash flow management, non-profit.
3. Saving some cash reserves to use in times of recession.
4. Use the cash flow worksheet.
5. Collect dues as soon as possible.
6. Request Clients to pay faster.
7. Extent accounts payable as long as possible to save the cash flow for the most important





business.

8. Appoint the Cash Flow Controller.
9. Use the technological development.
10. Implement more stringent procurement procedures.

This can be done by following a procurement strategy that is applicable for the firm such as selected reaction monitoring (SRM) method which will assist to manage the procurements. For example, in case of purchase asphalt road, a firm should do the following as per SRM method:

1. Identify more than one supplier.
2. Resource segmentation.
3. Relationship analysis.
4. Relationship management.
5. Evaluate the best supplier.
6. Reducing employees' salaries.

Firms are paying salaries to the employment as an exchange for the services provided by the employment. It is consisting of a different component such as allowance, basic salaries, overtime... etc. These components create salary structure and change in any salary structure can have a significant impact on what an employee does.

During the economic recession, a different salary structure components cost has been changed and modified. So, construction industry firms have to change components cost as per the market values. Following is a classification of salary structure components and the extent of their impact during economic recession and how construction firm can get benefits during the economic recession.

1. Basic wage
2. Flexible pay components
3. Work hours
4. Dismissal of permanent or temporary workers
5. Hours worked per day, week and month
6. Non-labor costs

**i. Basic wage**

A previous study is done by (Glassner, Vera; Watt, Andrew, 2009) on the reduction of the basic salaries for the employment results that firms are willing to reduce the basic salaries as the first strategy during the economic recession.

Percentage of Employees wage cuts		
Year	2007	2009
Austria	0.1	1.2
Belgium	0.2	0.3
Czech Republic	1.1	3.7
Estonia	0.1	30.4
France	0.9	1.2
Italy	0.1	1.1
Netherlands	0.8	1.2
Poland	3.8	2.6
Spain	0	1.4
Non-euro area	3.1	3.7

**Table 2.** Wages percentage cuts



The European central bank did a survey as shown in table 1 above for different firms in different countries in the average salaries cut percentage in the year 2007 before the economic recession started and after the economic recession in 2009. It is noted that percentage increased in all countries in 2009 and firms was trying to maintain themselves from bankruptcy.

The situation in Oman is that the Ministry of Man Power set a minimum basic salary for each education level as following:

1. 325 O.R for secondary school certificate
2. 425 for diploma certificate
3. 550 for higher diploma certificate
4. 600 for bachelor certificate
5. 900 for PHD certificate

Ministry of Man Power forces all firms that registered in the Ministry of Trading to give a minimum basic salary regardless the firm situation during the economic resection. So, firms cannot break the regulations of the Ministry of Manpower.

**ii. House rent allowance**

Since 2008, after the global economic recession, house rent price is going down because of less demand for the residential flat and houses (Oman Real Estate Association, 2016). Based on statistics done by Oman Real Estate Association in 2018, the house and flat rent reduce by more than 20%. So, construction industry firms can reduce house allowance commensurate with the location of the accommodation of the employment, so employees will not be affected by the additional financial burdens when reducing the housing allowance.

**iii. Medical Allowance**

Most of the construction industry firm provides two types of insurance to employees including medical insurance and social security insurance. Social security insurance is mandatory where medical insurance is not mandatory because there is a free government treatment available. So, construction firms can reduce their expenditure during economic recession by the cancelation of medical insurance as there is an alternative free treatment. Table 3 shows an example of the medical insurance cost per employment per year from AXA insurance company.

Age (year)	Cost
≤ 5	267
From 5 to 10	290
From 10 to 20	310
From 20 to 30	380
From 30 to 40	420
From 40 to 50	460
≥ 50	520

**Table 3.** Average medical insurance cost per employment per year (Source, AXA, 2019)

**iv. Conveyance Allowance**

Conveyance Allowance also knows transportation allowance. After the economic recession, in the Sultanate of Oman, Omani government has lifted subsidies on oil derivatives and the price of oil is determined monthly. These allowances must be changed according to the monthly oil price depend on the firm policy regarding how they are calculating the conveyance allowance. Table 4 shows an example of oil price in the August, July and June.





	June	July	August
	Cost per Barrel /Biza		
Fuel 90	210	205	210
Fuel 95	221	215	220
Fuel 98 max	298	294	299
Diesel	251	245	250

**Table 4.** an example of fuel price (Ministry of Oil & Gas monthly statistics)

**v. Stopped staff recruitment and lay off unnecessary employees.**

Stop the recruitment process completely to reduce the expenses of firms’ salaries and get rid of some staffs who they are in excess of the firm’s need in the case of the inability of the firm to cope and improve its status with the days of the economic recessions.

**Conclusion**

The aim of this research was to assess the impact of economic recession in the construction industry and contractors on the Sultanate of Oman and then it suggested a clear strategy for construction industry firms to use it to overcome the economic recession.

The world has been exposed to many financial recessions such as the 2008 recession, which started in a country that has an economic weight globally such as the United States of America and then soon affect most of the world countries.

These fluctuations in the economy have created a budget deficit in Oman from 2009 to 2019 amounting to more than 4.6 billion Omani Riyals in 2015. Therefore, the Sultanate of Oman has reduced its spending on many development projects such as in the construction industry and increased taxes.

As a result, many firms in the construction industry, oil, health and education have directly affected by the economic recession because of the reduction of expenses in this sector by Oman Government. The construction industry is directly suffered because it is directly related to the expenditure of the Government of Oman from the general budget. The more shortage in budget deficit leads to a sharp reduction in spending on construction industry projects like roads, bridges, commercial and residential buildings, ports, dams... etc.

Accordingly, the Government of Oman has taken several decisions to revitalize the construction industry in light of the economic recession like reviewing and updating laws and legislations related to improving the business environment and attracting domestic and foreign investments.

Finally, the research suggests a strategy to save construction firms during economic recession by making changes in the management of the construction firm in three basic contracting procedures, cost control procedures and related financial procedures.

This strategy is to control the internal and the financial system of the construction industry firm in accordance with the current financial environment and at the same time search for a financial source different from what the company is doing or in a different way from what it was doing.

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