

Sector Study: Construction



Prepared for: Mining & Beneficiation Workstream

Prepared by:

Name : Daniel Thwala
Position : Sector Specialist: Manufacturing
Contact number : +27 65 586 4178 / +27 31 368 9604
Email : daniel@tikzn.co.za
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1. INTRODUCTION

The construction industry is a multi-faceted sector that comprises diverse activities ranging from site preparation, building activity through to maintenance and the renting of construction equipment. Compared to many other industries, the construction industry plays a vital role in South Africa's economy and is a significant contributor to economic growth. In addition, the construction sector allows the improvement of citizens' quality of life by producing new or renovated infrastructure. The South African construction industry is made up of number of multinationals as well as Small, Medium and Micro Enterprises (SMMEs). Because of relatively low barriers to entry, the industry comprises of a lot of companies, many of them remain unknown mainly as a result of their low capitalization and inability to work on significant projects.

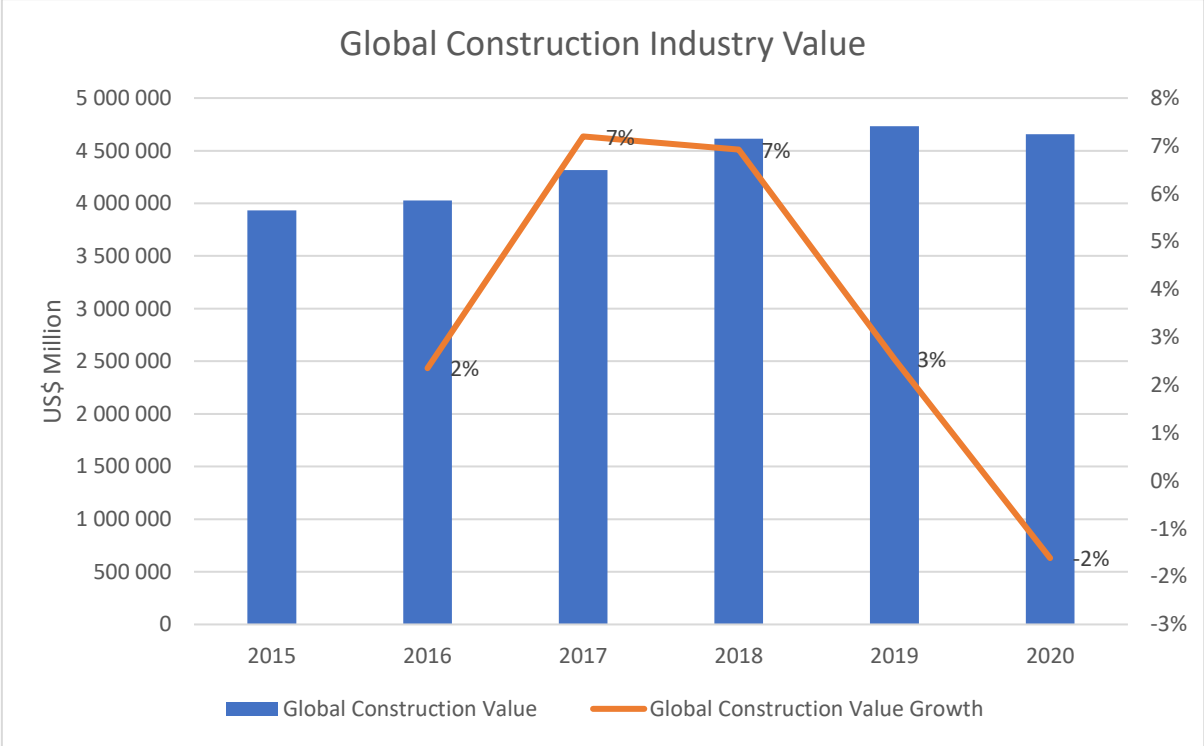
As part of a plan to revive an economy devastated by the coronavirus pandemic, the South African government has announced a massive infrastructure development programme. The KwaZulu-Natal province accounts for the largest number of general building and civil engineering construction contractors across Construction Industry Development Board (CIDB) grades 2 to 4. This report provides an in-depth analysis of the construction industry and further looks opportunities that the province can exploit to grow the sector particularly with regards to deepening the supply chain.

2. GLOBAL MARKET OVERVIEW

The construction sector is one of the major industries in the global economy accounting for a sizeable proportion of most countries gross domestic product (GDP). The growth of the industry is predominantly driven by government spending through capital allocation towards infrastructure development. Infrastructure development is critical for the most advanced economies as well as countries in the early stages of development. For developing economies, infrastructure such as the construction of roads and the installation of reliable electricity can have a transformative impact on citizens' lives and business prospects. In more advanced economies, keeping up with demand and building new and upgraded infrastructure is also the key to sustaining economic growth. According to Oxford Economics (2021), the global construction industry value in 2020 amounted to US\$4,7 trillion and the sector accounted for 13% of global GDP. In 2020, the industry

value contracted by 2% mainly attributed to the global COVID-19 pandemic and subsequent lockdowns. Figure 1 below shows the global construction industry value.

Figure 1: Global Construction Industry Value



Source: Fitch Solutions, 2022

The global construction industry is dominated by a number of large firms. In 2020, total revenue obtained by global firms within the industry amounted to US\$ 1,5 trillion. Majority of the largest firms in terms of revenue are located in China, France, Spain, Japan, the USA and South Korea, and they collectively account for 96% of total revenue. Table 1 below shows top 15 global construction firms by revenue.

Table 1: Global construction companies by revenue

Rank 2020	Company	Country	Revenue (US\$ Million)
1	China State Construction Engineering Corp	China	233 919
2	China Railway Group Ltd	China	141 180
3	China Railway Construction Corp	China	131 851

4	China Communications Construction Group Ltd	China	90 452
5	Metallurgical Corporation of China Ltd	China	57 952
6	Vinci	France	49 382
7	Daiwa House Industry Co	Japan	40 288
8	Actividades De Construccion Y Servicios, S.A	Spain	39 905
9	Bouygues	France	39 627
10	Shanghai Construction Group	China	33 505
11	Samsung C&T Corp	South Korea	25 595
12	Lennar Corp.	USA	22 489
13	Sekisui House	Japan	22 149
14	Larsen & Toubro Ltd	India	21 255
15	DR Horton	USA	20 311

Source: Deloitte, 2020

3. GLOBAL OUTLOOK

The industry is rebounding rapidly following the contraction in 2020 as a result of the global COVID-19 pandemic. The industry is expected to be the global engine of global economic growth towards 2030 averaging annual growth of 3.6%, the main drivers for this growth include large build-up of household savings, fiscal stimulus programmes by governments and population growth. Oxford Economics (2021) estimates that the industry growth will however be concentrated in a few countries, namely China, India, USA and Indonesia which will account for 58% of industry expansion.

In Africa, growth is expected to be highest in sub-Saharan Africa region, with average annual growth of 5.7% to 2030, as rising populations and rapid urbanisation provide powerful growth drivers particularly in East and West Africa. South Africa is expected to experience low growth over the period to 2030, while faster growing sub-Saharan African countries such as Uganda, Kenya, Ethiopia, and Nigeria are expected to propel growth for the region.

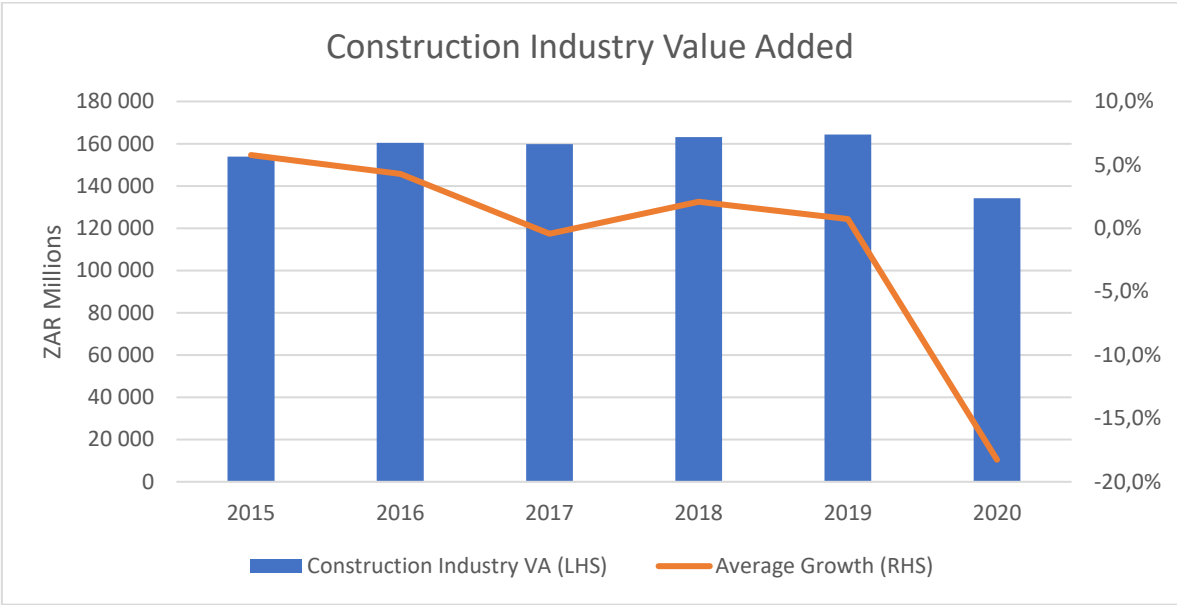
4. SOUTH AFRICAN CONSTRUCTION INDUSTRY OVERVIEW

The South African construction industry plays a vital role in the country's economy and is a significant contributor to economic growth. The industry consists mainly of three functions, namely, civil engineering; residential buildings; and non-residential buildings. These functions are briefly outlined below.

- **Civil engineering:** represent 49.6% of the construction industry and mainly refer to the construction of new and alterations to existing infrastructure, this includes, *inter alia*, highways, bridges, tunnels, railways, airfields, harbours, dams, reservoirs, irrigation systems, sewerage systems, pipelines, water cooling towers, mine-shafts, hospitals.
- **Residential buildings:** represent 31.6% of the construction industry and includes dwellings such as houses and flats, amongst others. Residential building activity also covers expenditure on major alterations and additions to these buildings, including the installation of permanent fixtures such as stoves, central heating, air conditioning, etc.
- **Non-residential buildings:** represent 18.8% of the construction industry and refer mainly to buildings and structures that are entirely, or primarily, intended for industrial or commercial use. Examples include office blocks, shopping centres, schools, hotels, factories, entertainment centres and other industrial buildings.

In 2020, the industry contributed R134 billion in gross value added at current prices to the South African economy representing a 2,7% share of the total GDP. Over the period 2015-2020, the industry value added declined by 1%, major contraction of 18% was recorded in 2020 mainly owing to the COVID-19 pandemic. Figure 2 below shows construction industry value added at current prices.

Figure 2: South Africa construction industry value added



Source: Statistics South Africa, 2022

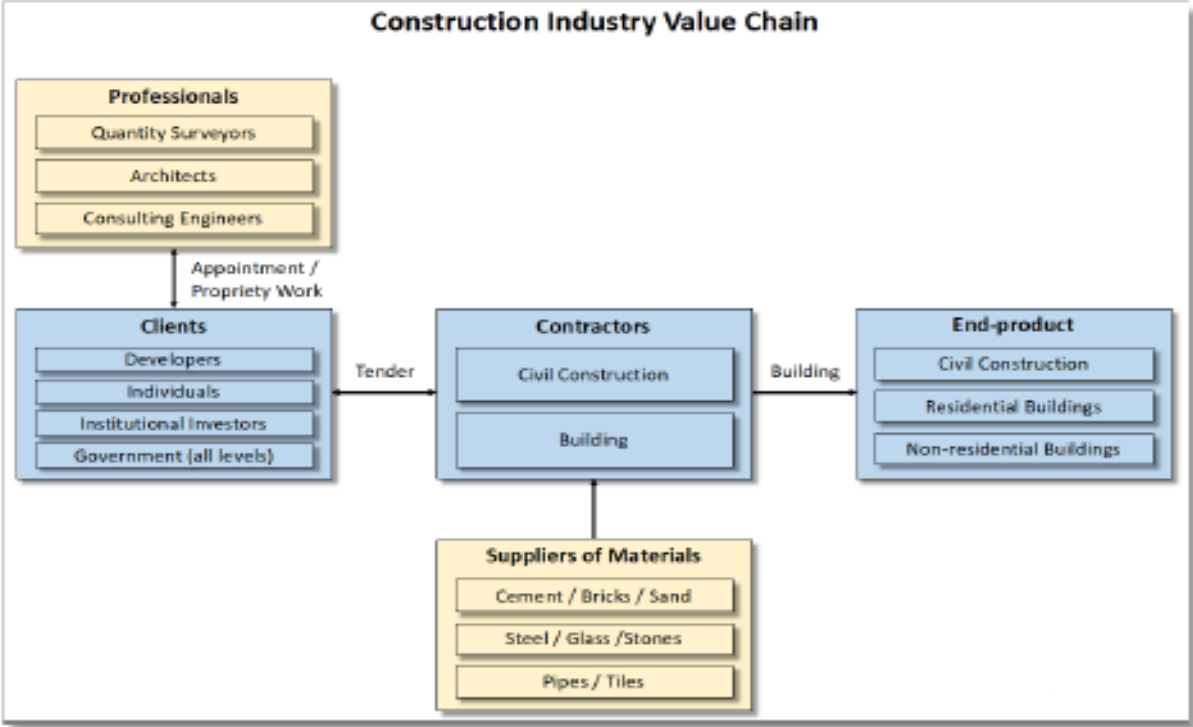
The construction industry comprises of diverse activities ranging from site preparation, building activity through to maintenance and the renting of construction equipment. The cyclic nature of the construction industry in South Africa makes it a bit difficult to determine the country's biggest construction company accurately. In addition, mergers and acquisition activities, which are common in the construction industry, also make it hard for any single company to retain the first spot for a more extended period. While the South African construction industry comprises of a lot of companies, many of them remain unknown mainly as a result of their low capitalization and inability to work on significant projects. Some of the major industry players include, *inter alia*, WBHO Construction, Group Five, Aveng Group, Raubex, Murray & Roberts Holdings and Stefanutti Stocks.

5. INDUSTRY VALUE CHAIN

The significance of the construction industry to the growth of the South African economy lies in the fact that the value chain is very wide and interlinks with various other industries. The value chain supporting the construction industry is extensive since it includes local producers, suppliers and importers of raw materials, components, building materials, equipment and machinery. The main sectors supplying building materials and machinery

include the quarrying, automotive and steel sectors. Figure 3 below shows the industry value chain of the South African construction sector.

Figure 3: Industry value chain



Source: Who Owns Whom, 2021

Vertical integration across the supply chain is common in the construction sector. Some large construction companies have restructured and have disposed of or are in the process of disposing non-core businesses to become more streamlined, while others are diversifying into mining, building materials and other sectors. Some industry players maintain that vertical integration is necessary if contractors are to function efficiently.

Another practice that is common in the construction industry is subcontracting. According to Construction Industry Development Board (2013) subcontracting is a business strategy that used by main contractors to manage uncertainties in the construction market. It allows the main contractor to reduce operating costs and thereby enhance competitiveness. Subcontracting is very prevalent in the South African construction industry, with up to 70% of building and 30% of civil construction projects subcontracted. The most prevalent types of subcontracting are labour-only, trade contracting in the building sector and specialist subcontracting in the building and civil sectors.

6. SWOT ANALYSIS OF SOUTH AFRICAN CONSTRUCTION SECTOR

<p>Strengths</p> <ul style="list-style-type: none"> • The most developed construction market in Sub-Saharan Africa and second in size only to Nigeria in nominal value terms. • The country has a mature banking and financial services sector on par with those of developed markets that enables firms to raise financing for projects in-country. • Barriers to entry for SMME are low. 	<p>Weaknesses</p> <ul style="list-style-type: none"> • There is a high level of reliance on the public-sector. • The government's ongoing focus on social spending and weak revenue growth means state-driven projects are slow to progress. • The industry is male-dominated, there is a shortage of skilled labour and it is often difficult to retain professionals with specialist skills. • The financial distress and potential disappearance of some of the largest domestic construction companies will compound the market's stagnation in the short term as the expertise and resources of these firms are lost and projects stall.
<p>Opportunities</p> <ul style="list-style-type: none"> • Demand for South African resources is driving investment in expanding the mining sector and supporting infrastructure. • The government is running a low-cost social housing programme to improve living conditions of citizens. 	<p>Threats</p> <ul style="list-style-type: none"> • Domestic and global economic recessionary pressures. • Escalation of geopolitical tensions. • Deteriorating labour relations in the sector delay projects completion.

- The rollout of infrastructure development projects in South Africa and the continent as part of governments stimulus packages.

- The growing debt load of state-owned enterprises poses threats to bringing existing projects to completion.

7. REGULATION OF THE SOUTH AFRICAN CONSTRUCTION INDUSTRY

The Construction Industry Development Board (CIDB) is a body established through the CIDB Act No. 38 of 2000 to oversee the regulation of the construction industry. The CIDB is responsible for monitoring and regulating the registration of projects and contractors and measuring the performance of registered contractors. The register of contractors is a vital component of the public sector procurement system. The South African Bureau of Standards (SABS) oversees the development and evaluation of construction standards, while Agrement South Africa evaluates non-standardised building and construction products and systems that are developed locally, but which fall outside the ambit of the standards or codes of practice of the SABS

8. MARKET DEVELOPMENTS

South Africa remains the largest infrastructure market in Sub-Saharan Africa, and it is expected that construction will recover as downward pressures of the COVID-19 pandemic on the industry ease. Although fiscal consolidation by government can exert downward pressure on public infrastructure spending which is a key driver of growth in South Africa's construction industry, there are plans to counterbalance this.

In 2021 Budget, the South African government announced plans to provide R791.2 billion of investment for infrastructure development in order to stimulate the economy from the effects of the COVID-19 pandemic. This includes, amongst others, the repair and replacement of the existing dam, bridge and railway line, the development of the housing, energy, agriculture, transport, water and sanitation and digital infrastructure sectors. Furthermore, officials from the World Bank, African Development Bank (AfDB) and

Development Bank of South Africa (DBSA) have pledged support for the infrastructure drive, which is expected to create over 1.8 million jobs over the next 10 years.

Some of the nationwide infrastructure development projects by both private and public sector that are currently underway, includes, *inter alia*, the following:

- As of September 2021, construction is under way on the R1,65 billion Msikaba bridge in South Africa's Eastern Cape province. A joint venture between local construction firm Concor and Portugal-based Mota-Engil is responsible for the construction of the 580m long bridge. The cable-stayed bridge is likely to be completed by the end of 2025 or in early 2026.
- In October 2021, Khato Civils, South Zambezi, and Zimre Capital have started preparatory works for traffic surveys as part of a feasibility study report for the modernisation of a Zimbabwe-Zambia-South Africa Road corridor. The feasibility report will determine if the road should be doubled, widened, or only resurfaced. It will also allow investors to select appropriate financial models to employ in terms of recouping their funds.
- In August 2021, the South African National Roads Agency (Sanral) awarded H&I Construction a R237 million contract to complete the remaining upgrade work of 27km of the R61 road from Bayiza to Mthatha Airport in the Eastern Cape province. The project was re-tendered in late 2020, after the initial contract was terminated in August 2019 due to non-performance by the previous contractor. Construction is due to start in September 2021 with completion expected in November 2022.
- Sanral is due to complete the construction of a R640 million ring road project in Limpopo Province in June 2022. The works include the construction of an 8km greenfield single carriageway to direct traffic from the N1 section 29 alignment just south of Musina towards the existing alignment in the north. The majority of the earthworks and storm infrastructure works associated with the project have been completed.
- Royal Bafokeng Platinum is studying the possibility of building a 30MWp solar photovoltaic power plant at its Bafokeng Rasimone platinum mine in South Africa. The firm is carrying out technical and economic feasibility studies for the project, with the studies expected to be completed in Q222. The project, if it materialises,

will reduce the mine's dependence on the national grid as well as bring down operating costs.

9. OPPORTUNITIES FOR KWA-ZULU NATAL

The construction industry has low barriers to entry, this makes it relatively easy for small and micro contractors to enter the market. With the government rolling out infrastructure development to stimulate the economy, opportunities exist for smaller companies to be integrated into the supply chain. The KwaZulu-Natal province accounts for the largest number of general building and civil engineering construction contractors across CIDB grades 2 to 4. These are contractors that mainly operate at a local level and have the capacity to execute government construction projects worth up to R20 million. In addition, the province boasts a total of 112 operating quarries making it number 4 province with most quarries nationwide. This presents an opportunity to deepen the value chain across the province by integrating the quarries as plans to accelerate national infrastructure development are in the pipeline particularly in industries such as energy, water, transport, human settlements, and telecommunications. Furthermore, the province is home to Desmond Equipment (Pty) Ltd and Bell Equipment Ltd, the only manufacturers of a wide range of heavy equipment for the construction industry, this can further play a vital role in deepening the local supply chain.

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