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INVESTING BEYOND THE CORE: THE CASE OF SOARES DA COSTA

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## **Abstract**

This study aims to analyze how Grupo Soares da Costa, a diversified group centered on construction, behaved in terms of strategy to the current crisis. More specifically, it purposes to understand why Soares da Costa was forced to abandon its strategic plan “Ambições Renovadas”, which was about diversification and internationalization, to decide to focus on its core business.

This study uses a SWOT analysis, the examination of the strategic plans and annual reports and the conclusions of two interviews that were carried out.

Being the construction sector such a traditional and significant sector to the Portuguese economy, it is important to understand what a company can do to overcome such circumstances. To deal with all the negative circumstances, Soares da Costa should give priority to projects that require low levels of initial capital and diversify geographically to markets with similar characteristics of Angola and Mozambique, where Soares da Costa already excels.

**Keywords:** Strategy, Construction, Diversification, Portugal

## **Introduction**

In the Strategic Plan presented on September 15 of 2010, the response of Soares da Costa (SdC), a diversified group centered on construction, to the poor prospects in the construction domestic market was to diversify to the energy and environment sectors (Soares da Costa, 2010a). However, by November 28 of 2011 an update to the plan stated that SdC would no longer invest in other areas and would focus on its core business (Soares da Costa, 2011). This study analyzes the case of SdC in order to understand how it is reacting in terms of strategy to the economic crisis in Portugal. The reasoning of making a strategic plan based on diversification and internationalization made sense, however the financial situation of SdC combined with the worsening of economic conditions in Portugal made it impossible to follow. Now, SdC should rely on projects with low capital requirements in countries with similar characteristics of Angola and Mozambique.

Most of literature regarding this subject - firms adapting to changes in economic context - is about technological innovation and new business areas. This study analyses a company having a traditional sector as the core business, which is neither a high-technology, nor a typical innovative sector. It is, however, a fundamental sector to the Portuguese economy, representing about 12% of GDP (GPEARI, 2011).

The work is divided in eight main parts: the literature review, the context of global crisis in Portugal and in the construction sector, the characterization of SdC, how the crisis affected the group, the analysis of the strategic plans, then the analysis of the risks taken by SdC, the recommendations and the main conclusions.

### **Leading through hard times, Intrapreneurship for overcoming crisis**

According to Pinchot (1978), intrapreneurs are “those who take hands-on responsibility for creating innovation of any kind within an organization.” Firms should encourage their ‘intrapreneurs’ in order to develop new markets and products. However, diversifying could be a hard task and the right timing is everything. This work deals with these both strands: the idea of diversifying to the energy sector and then the realization that the best thing to do is to continue focusing on construction, the core business.

According to El Namaki, there are four patterns of strategic behavior under turbulence: Seeking Concentration, Seeking Competencies, Seeking Focus and Seeking End Game (El Namaki, 2013). When SdC bought Self Energy in 2010 and reinforced its position in the international markets, the strategic behavior followed was the Seeking Competences, more specifically a Competency Acquisition Strategy, as it reflects the beginning of doing business in different areas. However, with the reversal the strategy behavior followed was the Seeking Focus, which confines the scope of the company’s competencies to a core aptitude – “narrowing the scope of company competencies and the actual confinement to a core” (El Namaki, 2013).

Analyzing the destiny one decade later of the Fortune 500 Companies of 1994, 153 of those companies had either gone bankrupt or acquired and 130 had made a decisive change in their core business strategy. However, only half of these companies succeeded in their strategy. According to Zook, the general path of a company can be described as a focus-expand-redefine cycle: a company starts well on focusing on what it outdoes, and then expands its core in order to grow (Zook, 2007). The issue is that this cycle has been accelerating more and more. Currently, companies face more and faster change than ever before, due to innovations, globalization or to periods of

economic uncertainty, so they must act in order to prosper. However, caution is imperative as Zook warns, several companies precipitately leave their core business “in the pursuit of some hot market or sexy new idea” to then realize the mistake it was. Not every company that finds itself in hard times has to rethink its whole strategy. Changing the core business is not synonymous of having success. This study aims to analyze why SdC tried to diversify to other sectors, like energy, and then had to refocus on the core business again.

### **Global Crisis, Portugal and the construction sector**

In 2011, Portugal began the implementation of the EU-IMF financial assistance program to enhance growth and control the excessive debt, as the global crisis brought to the surface weaknesses and imbalances in the Portuguese economy (OECD, 2012). In 2009 the GDP fell by 2.6%, which meant a severe breaking, notwithstanding not as severe as in the euro area as a whole, due to the low exposure to toxic assets and the inexistence of a real estate bubble in Portugal (OECD, 2010). Portugal felt the tough consequences of the global crisis in 2009 and 2010, with the debt rate being downgraded, the sovereign debt crisis and the correspondent spreads increasing, which translated into hard periods in being able to finance the economy, mainly due to the lack of confidence from the investors. Two of the consequences were the decreasing of GDP (table A1, appendix) largely due to the contraction of domestic demand (INE, 2012) and the increase of the public debt from 68,4% of the GDP (2007) to 94% (2010) (Figure A1, appendix). The unemployment rate also amplified substantially (table A2) with values of 7.9% in 2007, 10.6% and 16.4% in 2010 and 2013 respectively.

The construction sector includes the construction and renovation of buildings, residential and non residential, and public works. It is affected by several unique distinct

factors: the weather conditions, the bank interest rate to finance the activity and the legal requirements to obtain licenses and certifications. Furthermore, the activity is subject to great instability concerning the periodicity and is also a nomad activity, as all the necessary resources have to be reallocated in the new construction site (Morais, 2010). The construction sector serves as barometer of the Portuguese economic activity, since it is immediately affected as the economic context changes: during times of economic prosperity the government invests substantially more in this sector, by increasing public works contracts, than in times of economic trouble. The same declining trend exists for private demand in the housing market. All in all, it is a vital sector for the economy mobilizing large resources and driving many other activities.

The construction sector in Portugal was one of the most affected by the global crisis and the sovereign debt crisis, mainly due to the high level of saturation concerning the housing and office markets (Fernandes, 2011), to the credit crunch and to a continuous fall in the confidence level of the economic agents (table A3). The main factors have been constraining the construction activity, according to the sector, are exhibited in table 1. The factor with the largest variation is ‘Difficulty in obtaining bank credit’, with values of 9,25% in 2007 and 54,46% in 2013. In 2013 the credit granted to construction companies was inferior to 19 billion euros, the lowest value since 2004 (FEPICOP, 2013). At the beginning of the crisis banks appeared to be dealing with the global crisis relatively well. However, from 2010 onwards, Portuguese banks have been affected by the crisis due to the excessive reliance on foreign borrowing and excessive exposure to government bonds. Banks were forced to rely on the Eurosystem financing, as the access to debt market got difficult (OECD, 2012). The outcome was the contraction in the credit supply.

The crisis in the construction sharply affected the labor market. Employment on the construction sector had a steeper decrease than in total employment (table 2).

All in all, in 2010, which was the year that the crisis consequences really hit Portugal, the output of the sector decreased by 8,5% affecting the cement sales in -7% comparing to 2009 values (Soares da Costa, 2010b).

## **The Soares da Costa Group**

### Soares da Costa: from family firm to business group

The business group has its origins the early twentieth century, when José Soares da Costa founded SdC in 1918 (see table A4, for the group's evolution). During the 1940s and the 1950s the family firm was consolidated in Porto and during the 1960s it expanded to Lisbon, Algarve, Madeira and Azores. Throughout the 1970s, SdC entered the social housing construction segment and the internationalization process began in the 1980s to Venezuela, Angola and Guinea-Bissau. Diversification to engineering, public works, concessions of infrastructures and real estate businesses marked the 1990s. In 2002 the business group was created, with the establishment of the holding Grupo Soares da Costa SGPS, S.A. and four sub-holdings corresponding to the strategic business areas at the time (Construction, Industry, Concession and Real Estate). In the same year, the founding family sold its stake to Investifino – investment management society (holding) of Manuel Fino - that became the major shareholder. The group's organizational structure can be seen in figure A2.

The year of 2008 was marked by acquisitions: the Portuguese construction company *Contacto* and the North American *Prince*. In 2010 the group acquired a majority stake in Self Energy and in 2011 the first work in Brazil took place (Soares da Costa, 2013a).

### The group and the construction sector

In terms of net results, the Portuguese largest construction companies are: Estradas de Portugal, a public company, Teixeira Duarte, Mota-Engil, Sociedade de Construções Soares da Costa and Zagope (Albuquerque, Silva, Simões, Carvalho, & Pereira, 2012). Throughout this report, for comparison and benchmarking purposes, SdC will be compared with Teixeira Duarte Group and Mota-Engil. They represent the three largest private construction companies in Portugal.

In terms of rivalry, the construction sector is characterized by no relevant market shares and by fragmentation. It is a decentralized market, with many diversified operators, as the sum of the market shares of the six largest companies in the market as of October of 2010 – MotaEngil, Somague, Teixeira Duarte, SdC, Opway and Edifer – was between 20% and 30% (Autoridade da Concorrência, 2012). A new investment fund, Vallis Construction Sector Consolidation Fund, was created with the aim of controlling distressed medium sized companies of the Portuguese Engineering and Construction sector. According to Pedro Gonçalves, current fund manager and former CEO of SdC, this new company will have about the same size, in terms of business volume, of SdC (Pinheiro, 2012). Vallis Capital Partners is a holding company, whose share capital is 100% owned by its Founding Partners. The companies acquired by the fund since May 2013 (Edifer, Hagen, MonteAdriano and Eusébios) embraced a new commercial brand known as Elevo Group (Vallis Capital Partners, 2013). According to António Castro Henriques (current CEO of SdC) this fund does not represent a threat in terms of competition in Portugal, however it does in Angola (Fonseca, 2013a). In conclusion, it seems that due to the difficult conditions that the sector is experiencing, a concentration movement in the sector starts to emerge.



In 2013, SdC occupied the 108<sup>o</sup> place as the Largest International Contractor and the 205<sup>o</sup> place as the Largest Global Contractor according to Engineering News-Record. SdC group has four business areas: Construction, Concessions, Real Estate and Energy Services (figure A3). With a turnover of 800 million Euros in 2012, SdC has 4500 workers in the group's different subsidiaries (Soares da Costa, 2013a).

From 2007 to 2012, SdC turnover increased 46% and the EBITDA grew 99%. In 2012, 78% of its turnover was in the construction business, 19.5% in the concessions and 2.3% in real estate (Soares da Costa, 2013a) (figure A4 for more details).

Due to the present economic conditions in Portugal and the appealing conditions of some countries, more than 70% of the turnover currently comes from abroad. Internationally, SdC bets on high potential markets, namely Angola, Mozambique, USA and Brazil. In 2012, 44% of the turnover came from Angola, 29% from Portugal, 16% from USA and 8% from Mozambique. The remaining 3% are relative to other markets such as São Tomé e Príncipe and Romania. From 2007 to 2012, the international activity increased by approximately 52% (figure A5).

#### Changes in ownership and control

In 2013, the group's shareholder structure is divided in three parts: 71% of the capital belongs to Investifino (Manuel Fino's holding, 11% to Parinama and 18% are free float (figure A6). On 23 September 2013, economic newspapers announced the entry of the Angolan entrepreneur António Mosquito in *Soares da Costa Construção*, which meant the beginning of the recapitalization process of 70 million euros paid by GAM Holdings, controlling 66,7% of SdC construction sub-holding: SCC Construção SGPS. The agreement states that António Mosquito will choose five members of the administration board, while Manuel Fino will appoint the remaining two (Noronha,

2013). Although António Mosquito will control 66,7% of SdC construction capital, Manuel Fino imposed some rules that Mosquito will have to comply with: impossibility of relocation of the headquarters and a corporate change in the shareholder structure of the company. Furthermore, António Mosquito is also prevented from making decisions concerning increases or decreases of capital, fusions and dissolution, among others. Another important part of the agreement states that António Mosquito would not be responsible for the North American subsidiary, Prince (Silva, 2013).

According to António Castro Henriques the news are in general true, although poorly explained. The Angolan Investor, will enter in the group sub-holding named ‘SCC Construção SGPS’ (Fonseca, 2013a). Therefore, when the article says that Manuel Fino will still control the company decisions is in the sense that Manuel Fino controls 71% of the group holding: ‘Grupo Soares da Costa SGPS SA’. However, António Mosquito will have the decision power regarding the construction sub-holding. Manuel Fino is no longer the president, however António Castro Henriques remains as CEO - for a better understanding of the changes in SdC’s structure, see figure A7.

The Group SdC is now divided into two parts: the construction sub-holding, having António Mosquito as the major shareholder and the holding itself that represents the group. In terms of strategy, the entry of António Mosquito will change the fact that SdC Construções is no longer interested in reducing de dependence from the Angolan market, contrarily to what was said in the Strategic Plan “Ambições Renovadas 2014”. Another change affects the department “Serviços Partilhados” – department that provides services to all the remaining departments of the group - that was transferred from the holding to the construction sub-holding, contrary to what happened with Prince. According to Castro Henriques, this is natural, as the Angolan investor did not want to be dependent on the Group, which he does not control, regarding these services.

Furthermore, according to the 2013 report, the recapitalization enabled the restructuring of debt with some banks, related to the construction business, making it possible to maintain over 4000 jobs in Portugal and abroad (Soares da Costa, 2013b).

All in all, when the article says that Manuel Fino will still have control, is regarding the holding company. He will lose the decision power concerning the construction sub-holding, notwithstanding the restraining clauses on Mosquito's initiatives mentioned above. The bottom line is that SdC group remains the principal management entity concerning two main activities – concessions and real estate – and an active participant in the construction business in partnership with GAM. In this way the group no longer controls the construction business area (Soares da Costa, 2013b).

### **Soares da Costa Group and the crisis**

The crisis in the construction sector in Portugal began before the global crisis, as the sector cannot yield a positive growth since 2001, mainly due to the excess of residential construction, which was aggravated after 2008.

Taking into account that 89,5% of SdC's turnover in 2010 came from the construction business (Soares da Costa, 2010b), it becomes clear that the group suffered with the crisis and had to adapt its business strategy. It suffered particularly due to the slowdown in the public investment along with the measures of fiscal contraction that lead to a decrease in domestic demand and to an increase of the leverage, followed by the credit squeeze. Concerning public investment, the analysis of 'Public Works Awarded Contracts', is clear: public works declined by 39% from 2007 to 2009 (table 3).

## SWOT Analysis

SdC has to face all the challenges of having its business focused on the construction industry. The difficult conditions and prospects of the sector represent the major challenges of having construction as the core business in Portugal, namely the large impact in the group's profitability (table A5). The SWOT analysis was made based on the values of 2010 to see if "Ambições Renovadas 2014" plan made sense, as 2010 was the year in which the plan was created.

The market conditions obliged SdC to increase the level of debt, with the deterioration of the net debt to EBITDA ratio (table 4). Although the ratio decreased until 2008, the ratio always increased afterwards. Teixeira Duarte is the firm presenting the worst ratio in 2010 (9.18), but closely followed by SdC (8.66).

The main challenges faced by SdC around 2010 were:

- Weak prospects regarding the domestic market in terms of credit contraction, deceleration of the construction market and lower public and private investment;
- Too much dependence on the Angolan market: 34,64% of the turnover in 2009 and 38,60% in 2010 (Soares da Costa, 2010b);
- Too much dependence on the construction business: the turnover regarding the construction sector was 89% of the total, while the average of the largest Iberian construction groups was 61% (figure A8);
- Pressure to decrease the level of indebtedness - net debt/EBITDA of 7.5 in 2009 (figure A9);

The main consequences and challenges of SdC were highlighted previously and now the part of the SWOT analysis regarding the weaknesses and threats is addressed:

Weaknesses (internal factors)	Threats (external factors)
<ul style="list-style-type: none"><li>• Too much dependence on the Angolan market;</li></ul>	<ul style="list-style-type: none"><li>• Poor prospects for the domestic market;</li><li>• Contraction of the public and private</li></ul>

<ul style="list-style-type: none"> <li>• Too much dependence on the construction business;</li> <li>• High level of indebtedness;</li> </ul>	<ul style="list-style-type: none"> <li>investment;</li> <li>• Increase of spreads for the same level of risk;</li> <li>• Credit shortage;</li> </ul>
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Concerning the positive side of the SWOT analysis for 2010, the major strength of SdC, according to Castro Henriques, was its appreciable international profile:

Strengths (internal factors)	Opportunities (external factors)
<ul style="list-style-type: none"> <li>• Positive growth regarding both the turnover (from 2008 to 2009 from 853 to 936 million euros) and EBITDA (between 2008 and 2009 a growth of 4.44%);</li> <li>• High level of internationalization – 57% of the turnover in 2010;</li> <li>• Geographical diversification.</li> </ul>	<ul style="list-style-type: none"> <li>• African and Latin American markets with good prospects in the construction segment;</li> <li>• USA with good prospects concerning the renewable energies market;</li> </ul>

### **Designing a strategy to the group**

In 2007 the plan in force was “Ambição Sustentável 2007-2012”. From 2004 until 2007, the construction sector had performed better relatively to the overall market and the Iberian construction companies had higher appreciation than the sector (Soares da Costa, 2007). By 2006, 61.8% of SdC revenue came already from the international markets, 42.9% for Teixeira Duarte and 32.7% for Mota-Engil (Soares da Costa, 2007). In 2006 the construction Portuguese market had already the worst performance in Europe, with recession in all segments (civil engineering, residential and non residential). Regarding the non-European countries, Angola and the United States were the ones attracting SdC, according to the plan. Thus, the strategic vision enhanced in this plan was to continue the diversification path, investing mainly in the concession business, and eliminating industry and real estate areas that were no longer strategic priorities.

Meanwhile, the profile of SdC and the construction market had changed significantly. On September 15<sup>th</sup> 2010, SdC presented a new Strategic Plan called “Ambições Renovadas 2014”. Pedro Gonçalves, CEO of SdC at the time, described the plan as being an anticipation to the consequences of the crisis in construction sector and a way to react to the change in SdC profile: increasing investments in transports concessions, internationalization and market diversification (Soares da Costa, 2010b). Additionally, SdC recorded significant growth in terms of both turnover and profitability between 2007 and 2009, almost reaching the mark for 2010 (table A6). The return on capital employed also improved between 2007 and 2009 (table A7) almost reaching 5% in 2009, when the target was at 5.5% for 2010. All in all, the objectives of the former strategic plan became less challenging and should be revised.

#### Internationalization

Concerning the internationalization side the objectives planned were:

- Enter into the Brazilian construction market to reduce the dependence on the Angolan market and to benefit from the good prospects that the Brazilian market presented – according to the plan it should represent 25% of the consolidated EBITDA in 2014;
- Open the capital of the Angolan subsidiary to reduce both the exposure to that market and the associated operational risk;
- Expand the business in the United States in infrastructures and renewable energies;
- Search for business opportunities in Latin America and other African countries.

#### Diversification: Energy

Concerning the sectorial diversification, SdC planned to enter in the renewable energy sector. To do so, in 2010 SdC Group acquired a majority position in Self Energy

(Soares da Costa, 2010b). “Self Energy is the first Portuguese ESCO (Energy Service Company) that provides an overall service management of energy, to reduce costs and energy consumption, with guaranteed return on investment associated with the performance of the energy service provided” (Soares da Costa, 2013c). Paulo Jorge dos Santos Pinto Leal is the President and the company has 46 employees.

The decision behind the choice of the Energy sector was because of the highly attractive historical profitability margins and the good growth prospects justified the choice of the energy sector (figure A10 and A11).

Growth in this new market would be achieved by gaining specific skills through partnerships and acquiring small companies in the sector. The growth would be mostly organic, gradual and progressive, and the estimated investment 2010-2014 was planned to be between 20-30 million euros excluding acquisitions. The markets chosen to invest were Europe, Africa, United States and Brazil. The activities to develop were, among others: exploitation of small hydro power stations, delivering energy management services, and installation of power units, mainly solar energy. The target for the sector was to reach 19% of the consolidated EBITDA in 2014 (Soares da Costa, 2011).

The hydro power is fully commercial and is also a well-established technology. Furthermore, this source of energy is very flexible, as it can be used to deliver base-load power as well as to meet peak demand or can even be used as a storage system (Brown, Muller, & Dobrotková, 2011). It is important to keep in mind that the production quantities are dependent on the rainfall levels. Nevertheless, due to its inherent advantages the hydro power is the “dominant source of renewable energy worldwide”, representing 16.2% of global electricity production in 2009 (Brown et al., 2011). Since 1990, hydropower has grown by 50%, though it seemed a good technology to be considered by a group like SdC that aims to diversify its business even more.

SdC also considered investing in the installation of solar thermal power units. In the past years this segment had high growth rates (Brown et al., 2011). Taking into consideration that sunny climates benefit more from this technology, Portugal, Brazil, African countries and the United States seemed suitable countries to invest in this area.

Regarding Portugal, the renewable energies represent 45% of the total electricity produced and 38% of the electricity consumed. Portugal has favorable weather conditions to the production of energy based in renewable sources, especially when it concerns the hydric, wind and solar energies. To get an idea, the sector had contributed directly in 2008 with nearly 2400 jobs and it is expected that in 2015 the number of jobs will be approximately 5800, which represents a growth between 2008 and 2015 of 140% (Deloitte, 2009).

### **The volte-face – why?**

“Ambições Renovadas 2014” was created to face the changes in SdC profile as well as to improve the profitability and return of the shareholders, through geographic (internationalization) and sectorial diversification, due to the decrease of the domestic construction segment from 2009 to 2010 (-25,4%), which was not compensated at all by the increase of the foreign markets (4,9%) (table 5).

According to Castro Henriques, when public investment is growing, companies take many risks, increasing financial leverage. To finance this strategic plan and to reduce the level of indebtedness – one of the objectives of the plan, SdC foresaw the sale of some non-core assets. The divestments would total 150 to 170 million euros.

In 2010, when the consequences of the crisis started to show up, SdC should have been more conservative and able to predict what was to come, not implementing an ambitious plan like “Ambições Renovadas 2014”, specially knowing the leverage that would be implied in this plan. However, the truth is that in 2010, looking at the



situation of SdC (SWOT analysis), a diversification process seemed to be a reasonable idea to reduce the dependence on the construction business. The main problem of the plan was the increase in the indebtedness level.

On 28 November 2011, SdC announced an update to the strategic plan “Ambições Renovadas 2014” due to the worsening of the sectorial and economic conditions as well as the poor credit availability. The new strategic guidelines were oriented to: internationalization, construction sector and financial sustainability (Soares da Costa, 2011). Some plans would be maintained, namely regarding the investment in the African countries, Brazil and USA. However, the update to the strategic plan proposes to postpone the investment in the energy sector. According to António Castro Henriques, the poor economic conditions in Portugal were in fact the ultimate reason for postponing the investment, as well as the insufficient capital that threatened not only the expansion prospects but also the on going projects. It became very clear that the company had an urgent need of recapitalization. To get the capital needed, it is much easier for SdC to finance itself in Portugal, since the interest rates in the African countries are in general higher. However, the credit squeeze in Portugal made it difficult for SdC to finance itself and therefore go along with the initial plan.

The new strategic plan suggests that the investments in the energy sector were only postponed. Nevertheless, according to António Castro Henriques SdC should not invest in the energy sector even in the future. The specialized players in the sector already have enormous advantages and new entrants will probably not be competitive enough (Fonseca, 2013a). Furthermore, it would require large initial investments and SdC is not in a healthy financial condition to do that. Even some construction companies larger than SdC are going back on their decisions regarding investments in the energy sector. For example, the FCC, a Spanish company, is selling its concession

and energy subsidiaries. Paulo Pinto Leal, President of the Executive Committee of SelfEnergy, has the same opinion, in the sense that SdC should concentrate in the current strategy, since it is not good for a company to change its strategy too often. He evaluates the situation as follows: when the investments in the energy sector were planned, the sector seemed to be a safe bet. However, the attractiveness changed dramatically with the difficulty in getting credit to capital-intensive sector with returns over 20 to 25 years, not to mention the financing difficulties the group was facing (Fonseca, 2013b).

The sale of some specific assets would continue to be a priority and the reduction of operating costs became one of the mainstays to this update. This reduction would be in the fixed costs of the construction business, like reduction of manpower, costs with supplies and external services (Soares da Costa, 2011).

All in all, this new strategic plan aims to cope with the difficult economic conditions and to attain a significant reduction in the indebtedness level. Therefore, SdC is planning to have an extremely international profile in 2015 (80% of the turnover) and to reach a net debt to EBITDA ratio of 5.6 also in 2015.

### **Risks taken by SdC and the role of diversification**

As mentioned before, the construction sector faces a lot of distinctive risks, making this sector so unique. Nevertheless, it is also important to take into account the general risks involving all the business areas and the countries where the group operates. Firstly, there are the risks related to the business itself: operational risks – the ones that may affect the services or the clients' satisfaction; integrity risks – related to the possible internal and external fraud; human resources risks – linked to management

issues, leadership, authority limits, and so on; and financial risks – associated with exchange rates, interest rates (financing risk), liquidity risk and credit risk.

Secondly, the environmental risks that have to do with the competition, the political, economic and legal conditions, and new regulation or other type of change within the specific sector, which is the risk that most matters in this study (Soares da Costa, 2010b).

It is extremely important, as António Castro Henriques mentioned in the interview, to have a risk management department, as risk well managed can mean huge savings to companies. A risk management department may successfully plan ahead in order to ease the adverse effects of risk in a company's profitability (Edwards, 1995). It identifies the risks, analyzes them and finds ways of managing them (for a better understanding of risk management department practices see figure A12).

The risk resulting from the impact of business cycles affects any firm. One of the most known methods to dissipate this risk is diversification, but is it enough? Faghihi and Vahdat performed a study to investigate the diversification pattern in terms of new markets and respective performance of the largest international construction companies using the data published in Engineering News Record (ENR) top 225 international contractors (2005-2010), in which SdC was a part of ranked as number 103. The revenue listed in these top firms was the one earned abroad. The conclusion found was that, as the level of diversification increased, no relevant increase or decrease in the international revenue happened. In other words, a purely increase in diversification would not lead to higher international revenue (Faghihi & Vahdat, n.d.), meaning that diversification per se is not enough to boost international revenue.

Before committing to any project of diversification, SdC should stabilize the level of indebtedness as in 2012 reached the maximum value, much higher than Mota-

Engil and Teixeira Duarte (table 4). Nevertheless, SdC enterprise value has been increasing from 2006 until 2012, which meant an approximation in terms of enterprise value to both Teixeira Duarte and Mota-Engil (figure A13). Both Teixeira Duarte and Mota-Engil were already well diversified when it comes to investing in completely distinct sectors: 33% of Mota-Engil EBITDA came already from the environment sector (Mota-Engil, 2010), and regarding Teixeira Duarte only 59% of the turnover came from construction, the remaining came from sectors like energy, real estate, concessions, and so on. Moreover, 57% of the turnover was already non domestic (Teixeira Duarte, 2010). Both companies' strategies in 2010 were centered in internationalization and diversification and yet both companies suffered a mass decrease in the enterprise value, which did not happen to SdC (figure A13).

A question arises then: Is it worthy for a construction company to diversify to other sectors? The evolution of SdC EBIT in each business sector is in table 6. Besides reflecting the business profitability before the effect of the capital structure and taxes, which is suitable, as it is more appropriate to see the performance of each area as if the company was financially healthy, EBIT is better to compare businesses in different industries as capital expenditures differ across them. From 2010 to 2012, the EBIT of construction has been decreasing, as well as its margin, and that can be explained by the crisis in the sector that makes it difficult to have projects to generate income, while the fixed costs and capital expenditures remain high. The total turnover also decreased from 2011 to 2012. Despite the crisis, the concession and the real estate businesses were able to maintain a fairly positive EBIT margin contributing to an overall positive EBIT margin. In conclusion, if SdC had only relied on the construction business, the profitability and performance of the company would be even worse with negative EBIT levels for 2012. As the construction sector does not seem to be able to recovery to the

pre-crisis levels in the next few years (figure A14), SdC should definitely try to diversify more, paying attention to its already high debt level and the overall competencies needed, in order not to enter in industries in which SdC has no know-how. Diversifying is not a risk-free strategy: it involves costs of entering into a new industry/market, the possible culture clash, and so on.

Also, knowing the risks inherited to the activity and the uncertain future of Portugal, a series of questions arise: Why did SdC adopt such an ambitious strategic plan in 2010 (“Ambições Renovadas”) full of expansionist words and did not implement a more conservative plan to protect itself from the tough circumstances? In other words: why SdC was not able to predict the need for updating the strategic plan in a completely different direction? On the one hand, SdC could have predicted in 2010 that the crisis would have consequences in Portugal, namely in the financial system, but on the other hand, the majority of these capital investments have been already made in 2006/2007, almost simultaneously with the change in the shareholder structure and Fino’s entry in the group. It was then that SdC became the largest shareholder (33%) of Scutvias, bought CPE (Companhia Portuguesa de Parques de Estacionamento); and began the Auto Estrada Transmontana project, in which SdC had to mobilize 70 million euros of equity with a TIR of 9.5%. These investment decisions can only be justified with the long tail of expansionist environment that the sector had been experiencing. Nevertheless, this is only one more reason for SdC to implement a more conservative plan afterwards, rather than a strategic proposal with a great new number of investments and expansion. It is also the opinion of Pinto Leal that SdC should and could have been more cautious and conservative with the plan “Ambições Renovadas 2014”, as the signs were all there (Fonseca, 2013b).

## **Recommendations and prospects for the future**

Now that the risks have been stated, this part will focus on what SdC could do in the future to try to overcome this crisis, as well as to minimize the risk that comes from economic conditions through a strategy based on diversification.

One significant thing is the fact that the construction, concession and even real estate businesses have comparable cycles, so as a strategy to diversify, perhaps investing in businesses that could underperform during the same periods is not the best choice, although understandable due to the easiness to enter in such industries with the construction business know-how. According to ACH, although the risks of construction and infrastructures business are not equal, they combine themselves in temporal cycles, so we end up with an amplification rather diversification of the risks. The correlation between both sectors is quite large.

The betas of SdC, Teixeira Duarte and Mota-Engil, they are positive (table A8). Beta is a measure of risk/volatility compared to the overall market: having a positive beta means the stocks of these companies move in same direction of the market. The higher the beta, the higher the risk inherent to the stock, as they pay up exactly when the market is doing well. When the market underperforms they amplify the fall and negative evolution. What SdC could do is explore the possibility of having in its portfolio some participation in businesses with low (negative if possible) betas in order to forearm itself against the bad economic times. Broadly speaking, SdC should invest in business areas with low or negative beta to protect itself against future market downside risk.

It is important, however, to bear in mind that this may not be an easy task, as SdC has no experience in investing in this kind of sectors. Moreover, attention had to be

paid in order to this investment not be translated into a loss of focus on the core business, but to take advantage somehow of the capabilities of the company.

Chris Zook and James Allen, believe that companies that successfully sustained growth are the ones that expand their core business in related markets where they know they can thrive (Zook & Allen, 2003), for example still focusing on the core products, but selling them in new geographic regions. From what is disclosed to the public, SdC have been performing better in the African markets (which are experiencing economic growth) and that seems to be a good plan for SdC for the future, as long as SdC gives priority to projects that involve low equity investment, due to its high level of indebtedness.

All in all, geographical diversification to emergent markets similar to Angola and Mozambique, in which SdC already excelled seems to be the best idea, as the company may rely on the competencies it already has. Lastly, a good approach to enter into a new country with less uncertainty and in a faster way, would be by acquiring an already existing company in that market and go from there, instead of bringing a new brand to an unknown market. That would imply some investment, so SdC could consider a merger, that would decrease the amount of initial investment, or a consortia with local firms.

## **Conclusion**

Even if the core business is underperforming and becomes very attractive to step in new booming markets with tempting margins and growth rates, the history of corporation changes tells that chances are more favorable if the company looks for change and diversification within its core sector (D. Edwards, 2012). As António Castro Henriques mentioned in the interview, SdC plans to drive down the risks by investing in

other countries with similar characteristics of Angola and Mozambique and in the construction sector, as it is an already known “territory” (Fonseca, 2013a).

The risks of the construction business are somehow related to the ones of the concession, infrastructures and real estate business. As a matter of fact, the betas are positive, which means that the businesses tend to perform better when the market goes up and vice-versa. One way for SdC to diversify without amplifying the risks would be to invest in a sector with a low or negative correlation with the market.

Keith Cottam also debates the idea surrounding the concepts of ‘intrapreneur’: while an independent entrepreneur can simply develop a new product or idea using all its creativity, an ‘intrapreneur’ that comes up with a new idea is usually impeded to go along with it. All in all, the notion of entrepreneurship “does not fit well in the thinking of bureaucratic organizations” (Cottam, 1989), meaning an established company has always more difficulties in implementing entrepreneurial actions. Moreover, the situation gets worse in circumstances of economic crisis, as some minimum resources are needed to go along with new ideas. Additionally, SdC should have been more conservative in 2010, holding back new investments, as SdC had already invested a lot in 2006-2007. Now SdC needs to reduce the high indebtedness level in 2012 with a net debt to EBITDA ratio of 18.65, comparing with the levels of Teixeira Duarte (5.89) and Mota-Engil (3.24) (table 4 ), and then go along with some non capital intensive projects that could demand low initial investment. Maxim: assure high liquidity projects combined with low levels of capital resources. The financial situation ends up meaning that the room to take entrepreneurial actions is in fact significantly limited and reduced. Bottom line: until the financial situation of SdC is not under control, SdC should go for investments relying lightly on SdC’s capital, focusing on the core business in countries with similar characteristics as Angola and Mozambique. Then, SdC could investigate



the hypothesis of investing in segments that are not as correlated to the economic situation as the construction business.

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## Annex

**Table 1 - Factors Limiting the activity (%) for construction in Portugal (%) (INE, 2013)**

Data reference period	Insufficient demand	Unfavourable weather conditions	Difficulty in hiring qualified staff	Lack of raw material	Deterioration of sales prospects
2013	83,41	4,23	3,39	5,52	58,27
2012	83,21	1,36	4,15	3,24	55,97
2011	79,68	4,55	7,08	2,11	54,28
2010	82,03	8,07	8,36	1,91	49,33
2009	78,22	3,83	9,14	1,84	49,85
2008	78,50	2,93	13,32	1,72	47,13
2007	78,08	5,27	12,48	2,47	42,13

Data reference period	Interest rate level	Difficulty in obtaining bank credit	Licensing difficulties	Other	No obstacle
2013	34,56	54,46	12,87	24,20	11,62
2012	37,38	53,25	14,02	27,28	9,83
2011	39,14	52,95	16,73	26,88	15,41
2010	24,15	40,85	18,61	28,37	18,68
2009	19,78	40,69	19,92	34,83	25,58
2008	35,30	19,25	24,72	34,13	30,48
2007	24,05	9,25	23,05	32,47	30,82

**Table 2 – Employment in the construction sector, as a percentage of total employment (INE, 2013)**

% of total	2007	2008	2009	2010	2011	2012
<b>Employment in Construction</b>	11,04	10,68	10,00	9,69	9,10	7,7

**Table 3 – Public Works Awarded and Public Works Promoted (annual rate of change %) – (Source: Banco de Portugal)**

	2007	2008	2009	2010
<b>Public Works Awarded</b>	24%	30%	12%	-39%
<b>Public Works Promoted</b>	-7%	44%	-29%	21%

**Table 4 – Net Debt to EBITDA ratio of SdC, Teixeira Duarte and Mota-Engil (Source: Bloomberg)**

	2007	2008	2009	2010	2011	2012
<b>Soares da Costa</b>	8,38	6,96	7,67	8,66	9,26	18,65
<b>Teixeira Duarte</b>	15,23	11,36	10,74	9,18	10,20	5,89
<b>Mota-Engil</b>	7,27	6,25	5,18	4,65	3,86	3,24

**Table 5 – Main construction indicators of SdC - Source: (Soares da Costa, 2010b)**

Million euros	2010	2009	VAR.
<b>Turnover</b>	800	874,4	-8,5%
<b>- Portugal</b>	288,8	387,0	-25,4%
<b>- External Market</b>	511,2	487,5	4,9%

**Table 6 – Evolution of SdC Ebit and Ebit margin trough business areas (Source: Annual Reports)**

(million euros)	2010		2011		2012	
	EBIT	Margin %	EBIT	Margin %	EBIT	Margin %
<b>Construction</b>	32,3	3,80%	29,4	3,70%	-8	-1,10%
<b>Concessions</b>	19,9	19,50%	29	15,50%	26,5	16,90%
<b>Real Estate</b>	3,9	26,60%	2,5	35,00%	2,8	12,80%
<b>Self Energy</b>	-	-	-2,2	-25,40%	-2,7	-