

# **IMPLICATIONS OF THE GLOBAL FINANCIAL CRISIS FOR THE QUANTITY SURVEYING PROFESSION**

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## Abstract

The global financial crisis has had devastating effects on the international construction market and the quantity surveyors operating in it. In order to remain relevant, globally competitive and successful, quantity surveyors must now more than ever scan their business landscape in order to discern and adapt to imminent changes to their professional practice.

The paper discusses the implications of the global financial crisis through late 2008 and 2009 for the construction industry in general and the quantity surveying profession in particular. The collapse of the American sub-prime mortgage market and the ensuing repercussions are traced through the global economy. The rapid exhaustion of short term debt followed by plunges in shares and property values, leading to a near synchronised global downturn in construction activity is observed.

The effects of the crisis on the Australian construction industry are explored. Sector specific variations are discussed and the variances in private and public property sectors are highlighted. Quantity surveyors have experienced a number of resultant changes to their business landscape. Other than the fall in demand for construction related services, the complex economic environment has presented a number of threats and opportunities. Quantity surveying organisations are urged rethink international ties in line with emerging international centres of economic significance. The need for organisations to diversify their service offering is highlighted. The profession is urged to remember to drive for innovation and to proactively seek out and exploit avenues for adding real value for clients. The importance of retaining the right skills and experience in anticipation of economic recovery is reiterated. Finally, the renewed argument for the development of international best practice standards is summarised.

**Keywords:** *quantity surveying profession, global financial crisis, Australia*

# IMPLICATIONS OF THE GLOBAL FINANCIAL CRISIS FOR THE QUANTITY SURVEYING PROFESSION

## Introduction

The global financial crisis (GFC) has had devastating effects on the international construction market and the quantity surveyors operating in it<sup>[1]</sup>. Whilst the Australian economy has remained surprisingly resilient throughout the crisis, the major industries including construction, have not escaped unscathed. In order to remain relevant, globally competitive and successful, quantity surveyors must now more than ever scan their business landscape in order to discern and adapt to imminent changes to their professional practice.

The purpose of this paper is to discuss the implications of the GFC through late 2008 and 2009 for the construction industry in general and the quantity surveying profession in particular. Due to the relatively recent nature of events surrounding the crisis there is currently little in the way of empirically determined literature on the subject. The literature consulted to underpin the arguments put forward in this paper are primarily based on economic data and the views and observations of key economic analysts and industry leaders.

The paper sets out to identify the key lessons for the quantity surveying profession by reflection on recent events. The paper begins by exploring the underlying reasons for the crisis, before discussing its repercussions for the international economy and construction industry. The specific responses from the both the Australian Government and the marketplace are identified. The effects on the construction industry are examined and sectoral variances are highlighted. This is followed by a discussion of the implications for the Australian quantity surveying profession. Finally inferences are drawn regarding key lessons learned from the crisis and strategies for the profession going forward as local and international economies move toward recovery.

## The global financial crisis

The latest wave of financial globalisation surpassed not only the ability of governments to react, but also that of financial institutions<sup>[2]</sup>. The collapse of Americas' *housing bubble* was a key determinant for what has become the most severe and widespread financial crisis since the Great Depression. Profligate lending was extended to sub-prime borrowers which led to greater demand for housing. When over-stretched, borrowers were unable to meet their mortgage obligations, eventuating in a rapid unravelling of the sub-prime mortgage market in 2006<sup>[1,3]</sup>. This in turn prompted the failure of key primary financial institutions, which in the current interconnected financial marketplace set in motion an unparalleled global financial reversal as sources of short term debt rapidly ran out<sup>[1]</sup>. The key turning point for the Australian economy and much of the developed world was the collapse of American global financial services firm Lehman Brothers in September 2008<sup>[4]</sup>. As a result the global economy underwent a period of severe contraction; the far reaching consequences of which did not spare the international construction market<sup>[1]</sup>.

## The effect of the GFC in the international construction market

With the collapse of numerous major banks, the availability of the short term money disappeared almost instantly. By October 2008 interbank lending almost vanished. As short term debt became increasingly difficult to obtain and maturing loans were not extended, countless construction projects stalled. As property values and share prices fell sharply, business and consumer confidence also collapsed. Consequently the global construction market declined and projected forward workloads shrank considerably<sup>[5]</sup>. Many main contractors responded by bracing for the downturn and preparing for recovery by rationalising their operations and becoming leaner organisations<sup>[6]</sup>.

In an attempt to stimulate economies, governments worldwide were forced to invest heavily. These stimulus packages typically included major infrastructure works as well as more short term projects to ensure that cash would flow through economies quickly<sup>[5]</sup>. The consensus is that these stimulus packages have been effective in avoiding an even more pronounced downturn. Confidence now appears to be improving, worldwide stock markets are recovering, government stimulated construction works are underway and global finance channels are beginning to flow once more. The bottom of the market and subsequent recovery for most regions is estimated as 2010<sup>[5]</sup>. Global professional services firm KPMG reports on a recently undertaken global construction industry survey which indicates that despite the deepest global recession experienced in over 60 years the industry is now accordingly optimistic about the outlook<sup>[6]</sup>.

### **Australia's response to the GFC**

Throughout the crisis the Australian economy has fared better than almost every other developed economy; indeed it has succeeded in staving off recession<sup>[4,7]</sup>. The success of the economy is illustrated in the sustained growth experienced in the first quarter of 2009; a time when all of the G7 states were experiencing significant contractions and only two of 33 developed economies measured reported economic growth<sup>[4]</sup>.

One of the main enablers for the sustained economic growth was the relative kerbing of escalating unemployment, which despite all economic forecast managed to remain below 6 percent<sup>[7]</sup>. Australian treasury estimates in 2009 indicated that without the implemented stimulus packages, the unemployment rate may have risen to near 10 percent; stimulus measures are estimated to have provided around 210,000 more jobs<sup>[4]</sup>.

The Australian Government had used infrastructure spending in the past to support the economy. Lessons learnt from those experiences were that in many cases funds were too slow to flow through the economy and much of the infrastructure work was only commencing as the economy was already recovering. As such, the first stimulus package in the order of \$10.4 billion in late 2008 was mainly in the form of cash bonuses that would flow quickly through the economy to individuals<sup>[4]</sup>. Then in February 2009, a stimulus package focusing on quick start midscale infrastructure was released. This package included: \$14.7 billion for education infrastructure, \$6.6 billion on defence and social housing, \$3.9 billion for energy efficiency (much of which is directed toward existing housing stock) \$890 million road, rail and small scale infrastructure, and \$2.7 billion in business investment tax breaks<sup>[4]</sup>. The 2009-2010 budget delivered in May 2009 announced a further \$22 billion package for large-scale infrastructure focusing on land transport, clean energy and education<sup>[4,8]</sup>.

The consensus among analysts is that the government stimulus measures were indeed successful in avoiding disaster. However, the economy, and in particular the financial services sector has undergone significant and lasting change. Due to the difficulty of obtaining funds on the local and international capital markets, the number of independent lenders has reduced significantly. As a result, most industries are struggling with the higher costs of obtaining debt financing. Analysts are agreed that the credit is unlikely to ever be as cheap and easily accessible as it was prior to the crisis<sup>[7]</sup>.

### **The effect on the Australian construction industry**

The construction industry has felt the impact as much as any other. Reports from the Construction Forecasting Council indicate that the number of lenders providing loans to the construction industry has fallen to around 10 percent of pre-crisis levels<sup>[7]</sup>. However, as outlined above, government stimulus spending has been a welcome relief for the industry. As a result the outlook in Australia is relatively more optimistic than the international aggregate. According to KPMG's survey findings up

to 93 percent of Australian contractors hold the view that government stimulus packages will see an increase in opportunities over the coming 12 month period; compared with global contractors where only 65 percent are as optimistic. Reflecting on the past year half of global respondents indicated that their backlog and profits had increased or stayed the same as in prior years. More than two thirds of Australian respondents achieved or exceeded last year's levels and 75 percent of Australian contractors are expecting to meet or improve on current backlog and profit levels in the coming 12 months. However, indications are that margins on future work will be lower than at present; suggesting that contractors expect to maintain current profit levels by reducing or offsetting their direct costs<sup>[6]</sup>.

The direct effects of the crisis and corresponding mitigating measures have not impacted consistently across the property sector. The major property sub-sectors have each felt the effects of the crisis differently<sup>[9]</sup>. The long project durations of civil construction projects, has meant the sector has retained its pre crisis workloads for longer. However work is expected to fall off somewhat over the next two years<sup>[7]</sup>. Levels of activity in the non residential building sector are clearly split between publicly and privately funded sub-sectors. Particularly affected by the crisis are the prospects for the construction of office, retail and industrial buildings. Despite the resilience of consumer spending throughout the downturn, retail construction dropped markedly when huge amounts of forward workload were put on hold as investors sobered their profit expectations. Retail building is expected to begin its recovery to return to normal levels around 2012 as the positive sentiment returns<sup>[7]</sup>. Industrial property is in oversupply<sup>[9]</sup> and construction is not expected to recover prior to 2012. When it does, the highs experienced in 2008 are not expected to be repeated, as the major rounds of upgrades were completed<sup>[7]</sup>. Office building is not expected to begin recovering before 2012 following its 2008 collapse. Construction activity will remain very low until the profit outlook and credit availability for businesses recovers<sup>[7,9]</sup>. Accommodation construction is expected to remain weak, with no real short term recovery expected until at least 2013. This is due to the reduction in both business travel and foreign and domestic tourism resulting from the crisis itself and the strength of the Australian dollar<sup>[7]</sup>.

However, the outlook for the public funded sectors remains strong, particularly in education and healthcare. Building in the education sector has undergone unprecedented growth, due almost entirely to government stimulus spending on the sector amounting to approximately \$16 billion over three years. Levels of activity are expected to normalise after 2011. Similarly, construction in the health and aged care sectors is expected to remain high due to government spends on new hospitals. The ageing population continues to underpin demand for the aged care sector<sup>[7,9,10]</sup>. The head of Australia's Construction Forecasting Council (CFC) refers to this different state of affairs in the public and private funded sub-sectors as evidence of a *two speed* non-residential building sector. The CFC's latest reviews show building activity in government stimulated sub-sectors increasing, while private spending continues to remain in decline<sup>[11]</sup>.

In summary, the availability of credit for all industries has severely reduced. Despite risk premiums on credit returning to more normal levels, the reduction in numbers of independent lenders means businesses' ability to obtain debt financing remain heavily constrained. Due to government stimulus spending, in education and healthcare, construction in these sectors is expected to maintain solid growth before levelling off around 2011 to 2012. Conversely office, retail and industrial building, are expected to remain weak until around 2011 to 2012 when tight credit conditions are expected to have relaxed sufficiently<sup>[7,12]</sup>.

## **Implications for the quantity surveying profession**

### *Overview*

The effects of the GFC on the construction industry hold obvious implications for professional groups such as quantity surveyors who derive their income from the industry. This section looks specifically

at the threats and opportunities emerging from the new business landscape and how they might impact on the Australian quantity surveying profession.

### *Internationalisation*

As the global economy undergoes major restructuring the traditional polar model of United States' led global financial leadership is replaced with a broader multilateral model<sup>[26]</sup>. This destabilising has brought about new links between nations, evident in the G-20's newfound relevance as the increasingly powerful economies of states such as Russia, China, India, Iran and Brazil impact on the newly formed economic landscape<sup>[14,15]</sup>. Anecdotal evidence suggests that the impact of this new world order is already impacting on Australian quantity surveying organisation. The re-evaluation of international ties may result in local organisations divesting themselves of their partners in traditional economic centres; an example of this is the management buyout of the Australian division of Gleeds in late 2009. Subsequently rebranded as Lucrum, the newly independent business enjoys a strong project network throughout Australia and Asia<sup>[16]</sup>. Conversely, in an attempt to gain a foothold in the lucrative Asian markets, Cyril Sweett has recently acquired Padghams, a consultancy with a presence both in Australia and India, and the Hong Kong based Widnell Ltd<sup>[17]</sup>; demonstrating the increased relevance of Australian quantity surveying organisations as strategic geographical partners for larger multinationals.

### *Human resources*

Surveys in the UK indicate that quantity surveyors are more vulnerable to the effects of the crisis than their professional peers. Whilst there is not clear empirical data to underpin the reasons behind this observation, possible explanations include that quantity surveying firms may be operating with lower margins or may simply have a higher sensitivity toward economic forces and therefore acted quicker and more radically than their counterparts. Internationally, the response from firms has been to reduce exposure to the crisis by downsizing their workforce<sup>[18]</sup>. The sharp falls in the Clarius Skills Index for building and engineering professionals suggests that quantity surveying organisations in Australia may also have been forced to downsize their workforce. The index dropped from 104.1 in late 2008 to 100.8 in early 2009. This indicates that supply of professionals exceeded demand by around 1000; in stark contrast to the previous year's undersupply of nearly 5000 professionals<sup>[9]</sup>. Encouragingly, construction sentiment data from late 2009 shows that staffing levels are again on the rise<sup>[19]</sup>.

### *Dispute resolution services*

The tightening of credit markets and rise in insolvency has led to an increase in construction disputes. The constrained lending market impacts on the liquidity of clients' funding which is exacerbated when purchasers or tenants default. Principals become more likely to dispute claims for payment. Contractors are increasingly seeking recovery of payment from principals with limited cash, they are also more likely to submit claims for variations, latent conditions and delay costs. The rise in disputes is not expected to be sustained for the full duration of the crisis. Demand for dispute resolution is likely to reduce as the number of projects contracts, principals and contractors liquidate, and as project viabilities start to improve following from the eventual onset of economic recovery<sup>[18,32]</sup>.

### *Sustainability*

The sustainability agenda has suffered. However, sustainability was a core agenda for long enough to have become entrenched in the thinking of clients, designers and other key players<sup>[18]</sup>. According to the KPMG's recent global construction survey, contractors are now of the view that sustainability is



no longer seen as a source of a competitive advantage, but rather as a baseline necessity<sup>[6]</sup>. Nevertheless, clients are presently unlikely to be as willing to pay premiums for sustainable initiatives as they may have been in the past<sup>[18]</sup>. Meanwhile, as the threat of climate change remains sustainability regulation is advancing unchecked by the GFC. The National Greenhouse Energy Reporting Scheme (NGERS) is now enacted and the proposed Mandatory Disclosure of Energy Efficiency programme is due to commence this year. There is likely to be more sustainability regulation in the pipeline in response to this increasingly topical issue<sup>[20]</sup>.

#### *Construction business recovery*

An area which has experienced some growth in demand for quantity surveyors in that of construction business recovery. Essentially, this involves the application due diligence principles to partly constructed buildings. This is complicated with the added complexity of contractual disputes surrounding the partially completed project. Projects become cases for construction business recovery services when development stalls and the planned course of action for the sale or disposal of the asset is compromised. This has become a significant fee earner for quantity surveyors operating in particularly depressed markets such as Ireland<sup>[21]</sup>. There is no evidence to say whether there has been a similar rise in demand for such services in Australia.

#### *Emphasis on cost bottom line*

Despite the building popularity of triple bottom line accounting<sup>[22]</sup>, the GFC has lent emphasis to the cost aspect of the model evident in the rise of traditional fixed price lump sum tendering<sup>[19]</sup>. Whilst this is a step backwards for social and environmental sustainability, it does present quantity surveyors with an opportunity to showcase their advanced cost management abilities<sup>[18]</sup>.

### **Key lessons and considerations for the quantity surveying profession**

The GFC and the resultant reactions of markets and governments have had direct impacts on the construction industry and quantity surveyors. The key effects discussed above have highlighted a number of strategy and approaches for the consideration of the quantity surveying profession going forward.

#### *Rethink internationalisation*

As the destabilisation of the traditional global economic model brings about newfound emphasis for key G-20 nations such as Russia, China, India, Iran and Brazil, the Australian quantity surveying community must take a close look at where the emphases lay in terms of international ties<sup>[13,14,15,23]</sup>. Movements in the industry indicate that traditional alliances with organisations in western economies may fall be overtaken by new ties throughout the Asia-Pacific region<sup>[16,17]</sup>. As investment organisations consider alternative locations for capital investment. Location factoring employed to evaluate the relative cost differences for projects in new geographical regions will need to be developed, likely to necessitate the gathering of new cost data<sup>[24]</sup>. Alternatively, seeking out cooperative local partners, allied to an organisation can assist in deflecting competition from the multinational, whilst the local partner benefits from international knowledge sharing<sup>[25]</sup>.

#### *Industry and sector specialisations*

The GFC has clearly highlighted the need for quantity surveyors to pursue service specialisations covering all of the main construction sectors and sub-sectors. In particular;

- the difference in delivery times between civil construction and building construction projects means that they will react differently to economic cycles,
- civil and building construction are also invested in differently by governments attempting to stimulate economies in a rapid yet sustained fashion,
- the public and private sectors rise have been observed to rise and fall in almost opposing cycles, with the public sector in Australia providing most of the construction activity until the private sector recovers, and,
- further sub-sector variations due to the nature of market forces<sup>[7,9,10,11]</sup>.

Sector diversification is a strategy which the leading global consultants have been quick to implement. EC Harris and Davis Langdon both identify the realigning of service delivery with each of the main construction sectors with specialist possessing the ability to add real value as cornerstones of their global business strategy<sup>[21,23]</sup>.

### *Service diversification*

As the impacts have been felt worldwide, companies have had to re-examine their competitive positioning and the services they offer. Firms which offer diversified services have seen an increase in existing building and property services such as building and land surveying<sup>[18]</sup>. A breadth and depth of service capability relevant to the market which allows for innovation is penultimate<sup>[23]</sup>. Key areas which have demonstrated resilience or even growth in the face of market downturn include;

- sustainability services – boosted by continued legislating<sup>[6,20]</sup>,
- dispute resolution services – due to the rise in dispute as a result of the increased financial pressures on all parties to a construction contract<sup>[18,32]</sup>,
- cost management services – due to the increased emphasis on reducing cost<sup>[18,19,22]</sup>, and,
- construction business recovery services – required in extreme cases where live projects have stalled<sup>[21]</sup>.

### *Drive for innovation*

To be effective in new key international markets, firms must adapt to offer innovative value added services<sup>[27]</sup>. The profession must rethink traditional practices to involve technological advances that are better aligned to the new challenges. Successful change management will be critical to enable practices to adapt to the new socio-cultural, political, legal and environmental exposure, as preparations are made to take practices offshore<sup>[26]</sup>.

### *Focus on value rather than cost*

The increased relevance lent to the *more for less* agenda has reiterated the need to re-examine project alternatives. Whilst there is an instinctive reaction to simply reduce prices, the smarter alternative is to develop a deeper understanding of clients' objectives and to work with them to achieve the required outcomes. With the reduced availability to funds, sophisticated clients are not only seeking to outright reduce costs, but also to make productivity and efficiency improvements. For quantity surveyors, this means broader engagement, specialist insight, and focussing on managing value rather than simply cutting costs. To be effective, practitioners need to develop an understanding of what the client is trying to achieve, and then drive for outcomes that meet client objectives. Clients are showing interest in joint ventures and other forms of collaboration, in some cases even co-investment. They are looking for more performance-driven, long-term collaborative relationships with consultants who can demonstrate the ability to understand their needs. In order to meet this need, quantity surveyors must continue to diligently work toward focussing on long term value rather than just short term cost<sup>[28]</sup>.



### *International standards of best practice*

The onset of the global financial crisis has undoubtedly prompted greater demand for transparency from regulators and investors alike. Investors are demanding to know where their funds are being allocated. Investors want transparency of returns and debt financing<sup>[20]</sup> and this demand carries through to the allocation and management of construction expenditures. Creating international standards for cost data architectures would allow cost information at all levels to be understood and transferred worldwide, ensuring investor confidence<sup>[29]</sup>. Similar standardisation has recently been successfully adopted in accountancy. International financial reporting standards have been adopted as the primary generally accepted accounting principles (GAAP) by domestic listed and unlisted companies for external financial reporting in Australia, New Zealand, Singapore and Hong Kong among others<sup>[30]</sup>. Similar moves by the international quantity surveying community would assist greatly in encouraging investor confidence back to the construction sectors<sup>[31]</sup>.

### *Investment in human capital*

Although organisations have felt the pressure to reduce their operational costs, in the knowledge based quantity surveying profession, the right human capital is the ultimate resource. Retaining the right knowledge skills and experience are crucial for when the industry makes its recovery<sup>[6]</sup>.

## **Conclusions**

This paper has presented a review of the recent global financial crisis and its effects on the construction industry and the quantity surveying profession in particular. The collapse of the American sub-prime mortgage market is identified as the underlying cause of the crisis. The ensuing repercussions are traced through the global economy. The rapid exhaustion of short term debt followed by plunges in shares and property values, ultimately led to a near synchronised global downturn in construction activity.

The Australian Government acted expeditiously in releasing a series of stimulus packages aimed at injecting cash into the local economy. The investment of funds into midscale infrastructure had the effect of creating *two speed* building sector where activity in some publicly founded subsectors reached record highs while the major private building markets remain dormant. An optimistic outlook is returning to the market and employment levels are again on the rise. The main private sectors are expected to recover around 2011 to 2012.

Quantity surveyors have experienced a number of resultant changes to their business landscape. Other than the fall in demand for construction related services, the complex economic environment has presented a number of threats and opportunities. These impacts have presented a number of key lessons for the profession to consider on the road to recovery. Quantity surveying organisations are urged rethink international ties in line with emerging international centres of economic significance, particularly throughout the Asia region. The obvious need for organisations to diversify their service offering to encompass all the major property sectors was highlighted. The same argument applies to extending building construction services to the civil construction industry. The diversification of services should also consider those which have been demanded in the recent downturn, namely: dispute resolution, construction business recovery, sustainability, and even traditional cost control services. The profession is urged to remember to drive for innovation and to proactively seek out and exploit avenues for adding real value for clients. The importance of retaining the right skills and experience in anticipation of economic recovery is reiterated. Finally, the renewed argument for the development of international best practice standards is summarised.

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