

What the construction sector's dire state of affairs means for companies and the economy

By [Clive Rumsey](#)

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The recent suspension of the shares of two South African construction companies, after they filed for business rescue, is a reflection of the distressed state of the country's construction sector. This sector - once a key part of SA's economy - is on its knees and has been in decline over the past decade.



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Earlier in August, Esor Construction, a major subsidiary of the listed Esor Limited, filed for business rescue. In June, the same fate befell Basil Read, who was also placed in business rescue. In July, the Liviero Group, one of South Africa's largest privately black-owned construction groups, was also placed in voluntary business rescue.

Esor said it is financially distressed due to, amongst other reasons, significant losses incurred on certain construction contracts and the "challenging economic environment currently being experienced in the construction sector".

Negative growth

This challenging economic environment can be seen in gross domestic product figures. According to Statistics South Africa (Stats SA), the South African economy wobbled in the first quarter of 2018, shrinking by 2.2% quarter-on-quarter. Although agriculture, mining and manufacturing were the main contributors to the slowdown, the construction sector, along with the electricity and trade industries, also recorded negative growth in the first quarter of 2018 compared with the fourth quarter of 2017.

The construction industry continued to contract, experiencing its fifth consecutive quarter of decline, according to Stats SA. The industry has lost R1.7bn in value since the fourth quarter of 2016, falling from R110bn to R108bn in the first quarter of 2018.

The industry had a “boom” during 2008 to 2010 when major capital projects were started – these included the stadiums for the FIFA World Cup, the Gautrain project, Sanral’s road project, and the building of two of Eskom’s power plants, Medupi and Kusile.

Lack of new infrastructure projects

Part of the reason for the current situation in the industry is the lack of new infrastructure projects being rolled out by the government. Slow economic growth in South Africa has a ripple effect on the industry and not many big new infrastructure projects are on the horizon. Due to various other factors, these big projects have all but dried up, leaving the big companies fighting for an ever-decreasing piece of the pie, and these large construction companies require major projects in order to sustain their overheads.

Add to that the big fines and penalties that construction companies had, or still have, to pay after being found guilty of collusion with 2010 World Cup Soccer stadium tenders, as well as companies being paid late, and you have the perfect storm in the industry. Policy uncertainty and corruption doesn’t help the situation. Government is also providing these “offenders” with less work, rather opting to give piecemeal projects to smaller firms.

According to Industry Insight, the environment for construction “remains unstable” and issues of poor or non-payment is particularly hard-hitting, and no longer just on smaller contractors, but also on medium and larger contractors.

Prospects not looking good

With economic growth of just over 1% expected for 2018, the prospects are not looking good. For the industry to be revitalised requires large construction projects to come onto the market and for increased expenditure in the infrastructure sector, both from government and parastatals, as well as large corporates, both in the petrochemical and mining industry.

There is potentially a silver lining and cause for optimism amidst all the doom and gloom. The demise of the large construction companies could result in an exciting future for smaller, black-owned constructors. While the large companies are under pressure and have shrunk, a middle tier of mostly black-owned businesses can develop out of the disintegration of the older and larger groups. These smaller companies could play a large role in improving the country’s infrastructure in the future and could even lead to new construction groups listing on the JSE.

The two distressed companies – Esor and Basil Read – have requested the JSE to voluntarily suspend the trading of their shares on the stock exchange after the business rescue announcements.

Business rescue

The business rescue provisions in the South African Companies Act came into effect on 1 May 2011 and provide the means to restructure and recapitalise a company or close corporation in financial distress as an alternative to liquidation. Business rescue provides for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders. The market will have to wait and see if these companies can be rescued.

A viable construction industry in South Africa is needed, but to rescue the industry as a whole, however, government needs to root out corruption, get the affairs of state-owned enterprises in order, and provide policy certainty to kick-start the economy, and consequently a lifeline for the construction industry.

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