Strategic Partnerships in the Construction Industry in Latvia

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Abstract In the modern world, where both business sustainability and competitiveness are among the main goals, none of the companies can survive without establishing some kind of informal or formal partnership with others, thus influencing the whole value chain. Meanwhile, business diversification has led to a multivariate construction industry structure challenging the traditional division of roles. Thus, the objective of the study was to establish the research methodology for the assessment of strategic partnerships, as well as to carry out empirical study on the extent to which the existing strategic partnerships influence the industry's value chain. There was carried out an analysis of the construction industry's structure in Latvia on the basis of the statistical data, developed the methodology for partnership analysis, approximated and analysed the major partnerships, and carried out the market stakeholders survey and focus group discussions to substantiate the findings. The study highlights partnership differentiation both by structure and strategic goals. It was discovered that customer-focused partnerships tended to last much longer leading to customer loyalty and repeated business, while profit-focused partnerships were often only a temporary solution, the major influencing factor for any successful partnership being the alignment of the strategic goals of all involved partners.

Keywords Business administration • Strategic partnerships • Diversification • Value chain • Construction industry • Latvia

1 Introduction

Construction industry is both an important part of any national economy and one of the most reliable indicators of its wellbeing. As a part of the national economy, it creates and improves the infrastructure for economical growth, provides jobs, as

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well as ensures a part of the national budget in form of taxes and duties. At the same time, the construction activity reflects the condition of both private and public sector, their financial and operating ability to satisfy their needs in terms of building new or reconstructing the existing housing, industrial buildings, financial centres, and infrastructure in general. In the modern world, where both business sustainability and competitiveness are among the main goals, none of the companies can survive without establishing some kind of informal or formal partnership with others within the same industry, thus influencing the whole value chain.

In construction industry two major trends are transforming the landscape. Firstly, in the incoming supply chain, the suppliers of construction materials are often the producers themselves, who not only develop the logistics side of business in order to benefit from direct sales, but also try to establish information exchange with construction companies to obtain data on the final consumer satisfaction levels, as well as to ascertain that their innovation direction corresponds with market development forecasts. Thus, disintermediation is more and more used for strategic development-focused partnership establishment. The second of the trends is business diversification leading to a multivariate construction industry structure where the role of the developer is often undertaken by municipalities and funding establishments. Meanwhile, construction companies themselves may often develop and even fund the construction projects in cases when the perceived market demand is not satisfied by traditional developers, as a result quite often offering leasing facilities directly to final consumers who might be interested in their projects.

Thus the objective of the study was to establish the research methodology for the assessment of strategic partnerships in the construction industry, as well as to carry out empirical study on the extent to which the existing strategic partnerships influence the industry's value chain. To reach the objective, there was carried out an analysis of the construction industry's structure in Latvia on the basis of the statistical data, developed the methodology for partnership analysis, approximated and analyzed the major partnerships, and carried out market players' survey and focus group discussions to substantiate the findings.

2 Construction Industry's Structure

Recently there has been plenty of research on various aspects of business environment in Latvia, showing that it is not only developing fast, but also managing quite successfully, due to attainment of EU funds, to adapt to ever increasing requirements of the European Union. The business activity registration has improved dramatically over the last 5 years with now only 3 days and much less effort and investment needed because of online service (Janovs and Zarina 2013). The number of active construction businesses in Latvia clearly reflects the national economy's development trend, nearly halving in the period from 2006 to 2008 (increasing from 4,011 to 5,924 registered companies correspondingly), then falling back dramatically to 4,248 registered companies in 2010, and recovering steadily over the next

4 years to reach 5,210 in 2013 (Ministry of Economics 2014). According to the national Register of construction businesses, the vast majority of construction businesses in 2013 were limited liability companies (4,825 out of 5,210), while only 2 % were general partnerships; meanwhile sole traders, shareholding companies and foreign companies each formed only 1 % of the total number of registered companies (Register of Construction Merchants of Latvia 2014).

According to the Central Bureau of Statistics of Latvia (2013) data on the number of companies operating in the area of construction (including those not holding permits for specialised works regulated by the national or EU legislation) the number of construction related businesses was 7,188 in 2012, 34 % of which dealt with the construction of buildings, 10 % with engineering, and 56 % with specialised construction works. In 2012, the turnover in the construction industry in Latvia was estimated 3.7 billion euros, with the added value forming 22.18 % of the turnover, while the total amount of goods and services purchased within production was 2.97 billion euros (Central Bureau of Statistics of Latvia 2014). Thus, it can be established that the share of the suppliers of goods and services within the industry formed 77.82 % of the whole construction production value in 2012, highlighting the importance of intra-business cooperation.

In 2012, the total number of employees in construction in Latvia was 59.4 thousand people, accounting for 412 million euros in labour costs, with average 6.9 thousand euros per year per employee in labour costs and 14 thousand euros per year per employee in added value. Sector specifically, the highest labour costs were in engineering (on average 10,840 euros per person per year), yielding the highest return in form of the added value (20,530 euros per person per year). The corresponding data for the construction of buildings were 6,090 and 14,000 euros, but for the specialised construction—5,357 and 10,430 euros per person per year. The engineering sector had also the largest companies in terms of the number of employees (on average 20.22 people per company), while in the building construction sector the corresponding number was 8.72 people (not much different from the national average of 8.26 people per company within the construction industry), but the specialised construction sector tended to have the smallest companies with the average of 5.88 people.

In the whole industry, 82 % of the companies qualified as micro-companies (with less than ten employees), while 14.44 % were small companies (10–49 employees), 2.89 % were medium companies (50–249 employees). Only 13 companies qualified as large (exceeding 250 employees), of which only three operated principally in the construction of buildings, but ten of them in engineering (CBS, estimated data for 2012). It should be noted, that though the average added value per person per year increased with the size of the company (7,563 euros in micro-companies, 8,886 euros in small companies, 14,703 euros in medium companies, and 18,458 euros in large companies), the turnover statistics per person per year are quite different—each employee ensured yearly turnover of 86,761 euros in the micro-companies and 79,484 euros in the large companies, while the corresponding figure for the medium companies was 65,361 euros, and for the small companies—41,552 euros (CBS, estimated data for 2012). Thus, it was clearly established that

not only the company size and its operations specifics should be included in the partnership research methodology, but also the intra- and inter-company relationships established and maintained by their employees.

It should be noted that the Doing Business index ranked Latvia number 24 (out of 189 economies), awarding high ranks for getting credit (rank 3), trading across borders (17), enforcing contracts (21), registering property (33), resolving insolvency (rank 43), paying taxes (49), starting a business (57), protecting investors (68) and dealing with construction permits (79) (International Bank for Reconstruction and Development/World Bank 2014). As the engineering and specialized building works are commonly carried out on the grounds of public procurement due to the national and local development strategies, the research results depicted in the present paper mainly focus on the construction and re-construction of residential and non-residential buildings. As shown in Table 1 above, the number of permits issued for new construction in 2012 seldom exceeded the number of those issued for reconstruction. These figures are important for the construction industry's value chain as they depict two major factors—the activity of the owners of existing buildings and the demand or perceived demand for new buildings. During the company survey, there were distinguished three major groups of clients—natural persons, businesses and public institutions. There was approximated that natural persons were the clients only in the very first two categories with 36 % of construction projects of one-dwelling buildings and 49 % of construction projects of summer cottages and garden houses. Similarly, public institutions (incl. municipalities) accounted for estimated 93 % of traffic and communication building projects, and for estimated 95 % of public entertainment, education, hospital or institutional care construction projects. The rest of all the permits were issued to

Table 1 Building permits issued in Latvia, 2012

Type of construction	Total	For new construction
Residential buildings		
One-dwelling buildings (excluding summer cottages and garden-houses)	2,072	1,317
Summer cottages and garden-houses	434	266
Two- and more dwelling buildings	190	43
Residences for communities	18	5
Non-residential buildings		
Hotels and similar buildings	58	32
Office buildings	100	23
Wholesale and retail trade buildings	164	61
Industrial buildings and warehouses	441	246
Traffic and communication buildings	53	30
Public entertainment, education, hospital or institutional care buildings	246	43

Source Central Bureau of Statistics of Latvia (2014)

various types of businesses, majority of them being limited liability companies, but also construction companies themselves (undertaking estimated 35 % of all new construction) and financial institutions (undertaking estimated 18 % of all new construction). Thus, the type of the client as well was established as a major factor to be included in the analysis of the construction industry's value chain.

3 Methodological Approach

The research depicted in the present paper was based on two fundamental concepts—the industry's value chain and the strategic partnerships. According to the famous definition by Michael Porter, the idea of the value chain is based on the process view of organizations, the idea of seeing a manufacturing (or service) organisation as a system, made up of subsystems each with inputs, transformation processes and outputs (Porter 1985). A more modern approach tends to use the concept of the supply chain instead to include all aspects of input, transformation and output processes (Nagurney 2006; Blanchard 2010); nevertheless the authors of the present paper prefer to use the concept of the value chain as to refer only to the value of the construction industry in general, not the particular activities that the construction consists of, which must become the subject of a much broader study.

At the same time, the concept of strategic partnerships is used in a much broader sense than common understanding of a formal arrangement between two or more businesses to combine strategic management with internal and external partnerships, whereas formal or informal, with the key stakeholders. A key stakeholder is an individual or group that can materially affect or e affected by a company's actions, decisions, goals, policies, or practices. Strategic stakeholders are those stakeholders that are vital to the organization and to the specific set of opportunities and threats that it faces at any specific point in time (Fleisher and Bensoussan 2003). Tyson and York substantiated that the notion of 'partnership' has come to be used as a way to describe an approach characterized by a unitary frame of reference, and a strong desire to harness the energy and commitment of employees to the flexibility and change orientation necessary for business survival (Tyson and York 2000).

Yet, not solely the employees influence the internal processes of a company. Dale describes distinction between external and internal suppliers and customers, where the later become part of quality management system providing feedback on goods produced and services provided (Dale 2003). The quality management system ensures customer satisfaction through learning, where 'strategic learning is a dual process of action and learning. Both loops operate simultaneously but are not often well synchronized (Carnall 2003). Yet, learning leads also to approximation of customer needs and further to innovation, which creates a new resource (Drucker 2011). Strategic inter-company partnerships allow for the use of each other's internal (and external) resources for mutual benefit. Kaplan and Norton describe how 18 natural business units of a company and 14 of its strategic partners

used the Balanced Scorecard to align strategic objectives and reached 17–19 % increase in business within a year. Yet, the execution of the strategy is perceived as much more important than its design (Kaplan and Norton 2001).

Thus, the company survey was carried out to obtain data for the multivariate analysis on the following aspects:

- The level of formalization of the partnership (percentage of the business operations covered with formal contracts)
- The vertical and horizontal integration of inter-company partnership within the specific field of operation (the ability of the partnership to provide the final product from the raw material to handing over to customer)
- The existence of defined strategies in the partnering companies
- The strategic focus (profit, customer, or business opportunity orientation)
- The managerial focus (the employee awareness of and participation in the strategy implementation)

There were surveyed nearly 23 % of the companies working in the building construction branch of the industry. The survey data were analysed on the basis of the size and the strategic focus of the company, further the results were discussed in focus groups with the representatives of the major partnerships (involving 6–15 partners).

4 Partnership Development Characteristics

The study showed that the concept of strategic partnership is well-known to most of the surveyed companies, and in most cases the companies had not only well defined strategies, but also some kind of strategic management system in operation ensuring employee, supplier and client awareness of the strategic objectives, mission and vision of the company. It should be noted, that the partnerships differed both by their structure (extent of integration, level of the formalization of the partnership) and the strategic goals (focus on increased profits, business opportunities, or customer satisfaction). Most partnerships covered from 75 to 85 % of the industry's value chain, but preferred what may be called a 'lean' partnership avoiding intermediaries such as logistics and re-seller companies, except cases where raw materials came from abroad and were distributed by a branch office of a foreign company or an official distributor. As well, the strategies could very seldom be defined as 'aggressive' aiming to gain a more significant market share.

One of the most peculiar findings of the study was the overall preference (96 % of all respondents) for cooperation both horizontally and vertically on semi-formal (68 %) or even informal basis (28 %). The discussion of the issue in the focus groups with the representatives of the major partnerships revealed that such approach was due to the general specifics of the construction industry, where the participation in an officially formalized partnership could lead to an exclusion of all of the partners from public procurement tenders in cases where any company of the

partnership had preliminary participated in preparation of the tendering documents. In regular market conditions this regulation would apply mainly to public procurement carried out by state and municipal institutions, as well as state-owned companies. Yet, in Latvia a large part of all construction and reconstruction is co-financed by the EU funds in private area as well, for example, the thermal insulation of the blocks of apartments; and in such cases an official public procurement procedure is applicable.

Another reason mentioned for non-formalization approach to strategic partnerships was the anti-monopoly legislation, which does not differ from the legislation in force throughout the European Union and the EEA, but hinders the establishment of large-scale formal partnerships that could risk gaining a monopoly position in the very small Latvian market and consequently losing part of their freedom of operation. Therefore, for national-scale projects companies tend to create a group offer based on the agreement of intention, but formalize their partnership only afterwards, when the construction project has been awarded. In such cases, even if one of the partners is excluded because of preliminary connection with the tendering documentation (or just simply does not qualify due to other reasons), the other partners still have a chance of winning the contract. Moreover, as in public procurement tenders only the main or lead partner is prohibited from submission of more than one offer, the small specialized companies may even sign contracts of intention with all the tender participants, in such a case getting their share of the deal regardless which of the partners wins.

The study showed that the strategic partnerships and corresponding strategies adopted may be distinguished in three broad categories. The first group included short-term profit-focused partnerships, formed with an objective to serve a particular customer need at a particular moment, commonly in the form of a particular project, e.g. public procurement tenders or large-scale projects. These partnerships were characterized by a rather or very high level of partnership formalization—typically in a form of formal contracts between the developer (usually a public or municipal organization or a bank) and the construction company. The formalization of the construction company's relationships with its suppliers depended on whether it was required by the developer. Within these partnerships, the strategic goals were well aligned and clear to all stakeholders covered by the formal agreements.

At the same time, several deficiencies were observed—for example, in such relationships there nearly always was no place for flexibility and innovation, as the works were strictly described in the contract. The quality mostly depended on how well the developer had prepared the technical specification, as for most such developers (public institutions, municipalities, banks) there was a fixed budget for each particular project. Most of the companies admitted that they would usually increase the profit margin by 10–20 % just in case they needed to cover expenses not foreseen by the developer. Such approach was regarded negatively as it decreased the competitiveness, nevertheless it was widely practised. As well, the employees were not required to participate much in decision making nor obtaining feedback on customer or final consumer needs or satisfaction.

The second group included medium-term partnerships with strategies that were typically business-opportunity focused. Such partnerships commonly included companies with operation differentiation, which allowed benefitting from both customer feedback and innovation implementation not solely within the particular branch of industry, but also other branches or even other industries. Contrary to the profit-oriented partnerships, the overall level of formalization in the business-opportunity focused partnerships was rather insignificant, as the companies believed that set prices and procedures may hinder or even endanger efficient use of opportunities. As well, employees were expected and encouraged to communicate at all levels between the companies, and particular measures (e.g. industry sports games) were introduced to promote this communication.

The main deficiency observed in these partnerships was the sense of insecurity resulting from the lack of partnership formalization. This insecurity was observed both at the lower levels of supply chain, as the companies had no guaranties for the future use of their innovations, as well as within the construction companies themselves in their relationships with employees. Quite often the strategies were well defined within each particular company, but no formal implementation mechanism provided in subordinate documents, such as labour contracts and job descriptions. Only the long-term employees and the management of the companies were positive about being aware of the company's strategy and inter-company cooperation procedures. Nevertheless, those aware of partnership relationships could quite freely on informal basis share the company's resources with their counterparts, as well as borrow the resources from partner organizations.

The third category distinguished was the customer-focused partnerships, which tended to have long-term strategies. Similarly to the business-opportunity focused partnerships, they had a rather low level of partnership formalization in general, yet aligned strategic goals and well-formulated guidelines for communication both with customers and within the partnerships. One of the largest distinctions from business-opportunity focused companies was the code of conduct included in job descriptions establishing not only the set of rules for working inside the company, but also for dealing with a clearly defined set of counterparts in partner companies. Another distinctive characteristic was the horizontal cooperation with the companies that would be commonly perceived as competitors. For example, in cases of not being able to satisfy the customer's desire within a reasonable time, employees were delegated the right to recommend the customer turning to an established counterpart in a partner organization. On the other hand, there were established initiatives and remuneration systems for finding innovative solutions.

The major setback encountered was that despite well-aligned mission, vision and strategic goals, the companies tended to have somewhat obscure framework for their implementation, as they usually had totally different sets of short-term goals, which were quite often contradictory and led to establishment of parallel short-term profit-focused or medium-term business opportunity-focused partnerships. Nevertheless, on the incoming supply chain side, this kind of partnerships gained the most positive references due to the well-established information circulation on the customer needs, as well as because of the certainty of return on investment in

innovations as those were developed in close cooperation with their further users (construction companies and end-users).

5 Conclusion

The study showed that the concept of a strategic partnership is well-known to the most of the surveyed companies, yet the partnerships differed both by their structure (extent of integration and level of the formalization of the partnership) and the strategic goals (focus on increased profits, business opportunities, or customer satisfaction). It was discovered that the customer-focused partnerships tended to last longer leading to customer loyalty and repeated business, while the profit-focused partnerships were often only a temporary solution. It was concluded that the major influencing factor for any successful partnership was the alignment of the strategic goals of all involved partners. If this alignment was not to be fully reached due to the conflicting interests of partners, the partnership was doomed to internal uncertainty, instability and the resultant short lifespan.

It is notable, the formalization of the partnership in short-term relations provided some assurance of the responsibility of each party, yet eliminated flexibility of operation and innovation, thus was not preferred in longer term partnerships. Though the strategic focus, level of formalization and integration of the partnership played an important role in the long-term partnerships, they did not have much influence if the partners did not cooperate within the same framework. At the same time, it was concluded that regardless the focus of the partnership, it was perceived as successful if it met the stated goals, regardless their focus on profit, business opportunities or customers, in which case it served as basis for further inter-business cooperation and formation of new strategic partnerships. At the same time, it should be noted that long-term customer-focused strategic partnerships lead to a phenomenon that might be called internal-formalization of externally informal relationships. This phenomenon might be due to just the small size of Latvian construction market and the companies' reluctance to gain the monopoly status, as this may lead to partial loss in the freedom of operation, nevertheless it requires a much deeper study.

As well, it should be noted that both the survey and focus group discussion results highlighted the existence of a multi-layered industry structure with the companies establishing short, medium and long-term strategic partnerships at the same time with the same or different sets of partners for different purposes. It should be noted that none of the companies was involved in only one partnership, the majority (58 %) of them participating simultaneously in 5–10 partnerships (covering estimated 50–85 % of the industry's supply chain), while 30 % indicated 2–4 existing partnerships (covering estimated 40–70 % of the industry's supply chain) and 12 %—more than ten partnerships (covering estimated 65–95 % the industry's supply chain). It may be ascribed to the tight market competition of Latvia that the existence of any signed business-to-business contract regardless its

subject is perceived as basis for informal partnership. At the same time, the focus group discussions revealed that such contract-initiated informal relationships indeed extended outside regular contractual relationships, involving communication on a much broader range of subjects than the fulfilment of the contract. As well, it should be noted that Latvian companies seldom changed the partner composition and/or the established goals within the existing partnerships, giving preference to the establishment of new parallel partnerships if needed, and maintaining the informal relationships even after the termination of the contracts.

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