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Representative Executive Officer
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Kibe Kazunari

[Kibe-log]

The future of the general construction industry proposed by INFRONEER Holdings Inc.

First of all, thank you very much for your continued support of the Maeda Construction Group.

I am Kazunari Kibe, the CEO of INFRONEER Holdings INC., a newly established holding company of the Maeda Construction Group as of October 1st, 2021.

As you may have been informed, Maeda Corporation, Maeda Road Construction Co., Ltd. and Maeda Seisakusho Co., Ltd. established a joint holding company INFRONEER and conducted a business integration. This is our transformation into an “integrated infrastructure service company”. Beyond the traditional general construction industry we aim to create a new Maeda group in order to be able to compete in the global market. We would highly appreciate your continuous support.

I hope this blog helps all of our stakeholders understand what INFRONEER Holdings is planning and what kind of society we can create through our new business structure.

To begin, I would like to tell you about our “de-contracting” strategy.

What’s “de-contracting”?

We have been shifting our business strategy toward more to “de-contracting” since 2011. Contracting is the business framework that maintains high quality of standards, meets promised completion dates and receives the payment from clients. In the construction industry it means the contractee orders construction projects and the general contractor who received the order coordinates with construction specialists and guarantees the completion of the project to the contractee.

It is safer and easier for the contractees to use general contractors to complete the projects under their full supervision as the contractees usually do not have such knowledge of constructions and civil engineerings. Also contracting is beneficial for construction companies to receive payment for construction without taking any associated business risks. Because of that almost all construction projects currently operate under this contracting framework.

On the contrary “de-contracting” that is, to “get out of contracting” means not only conducting conventional contracting business but also taking certain business risks on the projects. For example, we obtain operating rights of concession for infrastructure projects (e.g. airports, water and sewerage systems, toll roads, etc.) so that we can consistently manage construction, operation and maintenance of the facilities.

“De-contracting” business is a fee business on infrastructure projects with investment. It is possible to generate an even higher return than contracting if we could utilize engineering knowledge and financial know-how.

Successful transformation of large European contraction company from contracting business to construction service provider

Let me tell you about the story behind the idea of “de-contracting”.

It came from my bitter experience after the bubble economy had burst in Japan.

I was assigned to the Business Planning Department of the Maeda Corporation in the late 1990s after the bubble economy burst. At that time the construction industry was suffering tremendous difficulties caused by a worsening business environment and continuous scandals of bid-rigging. In addition, it was certain that Japan would become an aging society and eventually the demand for construction (mainly represented by the public works) would keep shrinking in the long term. Every day I asked myself a question about the future direction of Maeda Corporation as a member of the Business Planning Department.

During that time, I learned about the interesting movements of large European construction companies. They had been mainly conducting contracting business just like the Maeda Corporation. However, in the late 1990s some of them started to add new business streams with which they could enjoy the return on the investment of social infrastructure like highways and airports. It was a business built on the fees for operating and maintaining facilities. Well-known companies are Hochtief (Germany), Vanci (France), and Balfour Beatty (UK).

I was getting very interested in their stories. When I went to Europe for the Investor relations meetings, I made an arrangement to meet with these companies’ executives to learn more about their initiatives in detail. I had learned that the establishment of the European Union, and the fundamental risks in the contracting business had caused a paradigm shift in the European construction industry.

What is the added-value for a construction company?

One of the EU's principles was free competition. Large construction companies of developed nations such as Germany or France competed in open bidding with other companies of nations that had newly joined the EU. These new companies were from developing countries and offered better prices by utilizing lower labor and operating costs. Many companies got into a price war and could not expect a profit in conventional contracting businesses.

Among those struggling companies, large construction companies in Germany and France added more risk-taking concession business of public infrastructure, that is, integrated construction service business, onto their business line. They shifted their strategy from depending on conventional contracting business to taking more business risks in concession businesses in order to generate better profit. I can imagine they did not have any other choice at that time.

Contracting is a so-called high risk and low return business. Established construction companies are exposed to unprofitable risk as new entrants can always offer the lower price. Expected return is limited because business risk is not taken on by the companies. Also differentiation is difficult as it is regular open bidding.

On the contrary if companies are invested positively in the project by being involved in the project's operation, maintenance and control, the return on investment is bigger when it succeeds. As concession business contains a certain level of risk it could be mitigated by the company's specialties in engineering and expertise in finance. This is the true differentiation and value-added initiatives. The division director of Hochtief told me, no business risk, no value-added. I agreed.

The shock of the Palmisano report

I'm going to tell you another story of how I came up with the idea of an integrated construction service provider, which is indispensable for our industry. It began when the Palmisano report was published in 2004 in the US.

The Palmisano report was made by the US Council on Competitiveness. It is well known for its proposal that innovation should be the only and strongest driver for the US economy to keep growing continuously in the 21st century. The report suggested that the US should shift from the manufacturing industry toward the service industry and emphasized the importance of innovation especially in the field of service efficiency.

The Palmisano report was named after Samuel Palmisano of IBM, the chairperson of Council of Competitiveness at that time. When it was published in 2004, IBM was about to transform its business model from PC manufacturing company to IT consulting services company by selling their PC department to Lenovo. IBM was working hard as a whole to focus and move to the direction of a service economy and innovation.

In the construction industry, the movement of service industrialization is shown as the fee business, such as project management (PM) and construction management (CM). In the US construction industry, contracting business is only handled by local state construction companies. Large national construction companies have already shifted their business to PM and CM.

How to make an innovative construction company

With the drastic change that had happened in the European construction industry caused by the establishment of the EU and the growth of service industrialization in the US, I was certain that this paradigm shift would eventually come to Japan. Currently, Japanese construction companies compete with each other to win the projects for public works, but I believe that in the coming years the budget will shrink and competition will grow fierce, just like what happened in the EU. This is why I believe Maeda should be the first to jump into the infrastructure business to survive by promoting de-contracting.

I also believed de-contracting may solve pressing social issues in Japan.

The effects of our aging society and declining population will only accelerate, and the cost to maintain and renew our outdated post war infrastructure continues to grow. The maintenance and renewal of social infrastructures need to be done by the collaboration of public and private sectors.

Maeda Corporation declared a de-contracting strategy in 2011. Since then Maeda has won domestic concession projects such as Aichi Prefectural Toll Road, Aichi International Exhibition Center, Sendai Airport. De-contracting business has been steadily growing. We expect de-contracting business will account for 3% in sales in this fiscal year, but it will contribute around 20% to ordinary profit. 20 years have passed since I learned this new business model of the construction industry. It finally reached to the stage which we can call it as a business. I am very glad to be involved in the realization of what I dreamt of today as a CEO of INFRONEER Holdings.

The demand for construction has not shrunk as we anticipated because we have extraordinary demand in rebuilding after the Fukushima earthquake as well as the Tokyo Olympics. However, it is not possible to expect further growth in the construction industry, when taking into account future population decline and increasing costs of social security. While contracting is still our main pillar in our business domain, I believe de-contracting will be the right direction for the future of our company.

In order to continuously grow the Maeda group, to build an innovative construction company, and to maintain a high quality of social infrastructure, I promise to do my best to manage INFRONEER and I thank you for your continued support.