

ISLAMIC ECONOMICS THEMES IN THE STRATEGIC PLANNING OF MERGERS AND ACQUISITIONS IN THE MALAYSIAN CONSTRUCTION INDUSTRY

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ABSTRACT

This paper investigates Islamic economics themes in strategic planning for mergers and acquisitions in the Malaysian construction industry. It provides dedicated focus, direction and commitment to organizations to achieve their goals effectively and efficiently. In a competitive market, every firm tries to minimize cost by being efficient so that it can optimize potentials and competitive positions. The research questions are: (a) What are the Islamic economic factors that firms in the construction industry need to consider when adopting M&A strategy in the construction industry, and (b) What is the degree of the importance of each of the factors mentioned? The study conducted personal interview with the 11 construction managers. The results of personal interviews gave five Islamic themes, namely (1) Unity of God (*tawhidic*) paradigm, (2) justice (*'adl*), (3) trust (*amanah*), (4) promoting good governance-prevention evil (*amr bil ma'aruf nahi anil mungkar*), and (5) vicegerency (*khalifah*) that supported M&A strategy. In terms of practical implications, this study facilitates strategists or planners with common guidelines to plan strategically for M&A. The study suggests the future research to use mixed method (questionnaire survey and personal interview) and include more informants, particularly industry key stakeholders.

Keywords: Islamic economics, strategic planning, mergers and acquisitions

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1. INTRODUCTION

This paper investigates Islamic economics themes in strategic planning for mergers and acquisitions in the Malaysian construction industry. The discussion of this paper is divided into literature review, research methodology, results, discussion and conclusion.

2. LITERATURE REVIEW

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The purpose of the study is to review research in the area of Islamic studies in general and Islamic economics and finance in particular.

2.1 Tawhidic paradigm in Islamic economics themes

The Islamic economic themes in this paper is based on the *Tawheedic* paradigm (Unity of God) that provides harmonious linkages between the worldly affairs (*al Dunya*) and the Hereafter (*al Akhirah*) in the context of business (Rahman, 1995; Beekun, 1997; Hamid, 1999). Based on this premise, the *Tawheedic* paradigm directs the obligations to promote goodness (*'amr bil ma'aruf*) and prevent evil (*nahi anil munkar*) (Beekun, 1997; Hamid, 1999). Prerequisites to one's execution of the fundamental duties are possession of knowledge (*al 'ilm*), true conviction (*al iman*), and integrity (*al ihsan*) (Mawdudi, 1991; Laming, 2002; Ismail, 2004). Knowledge incorporates broad concept of *ma'aruf* which includes goodness (*al khayr*), righteousness (*al birr*) and lawful (*halal*) which deserve positive rewards (*ajr*) (Mawdudi, 1991; Qardawi, 2007). *Munkar* includes bad (*sharr*), sins (*ithm*) and prohibited (*haram*), which are related to corresponding punishment (*al 'idam*) (Mawdudi, 1991; Qardawi, 2007).

The *Tawhidic* paradigm gives weight to the degree and quality of deed/actions. The foundation for the concept of Unity of God or Oneness of Allah is mentioned in the *Qur'an*, *Sura al Ikhlas* 112: 1- 4:

Say: He is Allah, the One and Only (1); Allah is the Self-Sufficient independent of all, while all are dependent on Him) (2); He begets not, not is He begotten. (3) And there is none comparable to Him. (4)

Ibn Kathir (2003) explains that the main reason for the revelation of *Sura al Ikhlās* is to reaffirm the oneness of Allah. *Tawheedic* paradigm moulds the super-logic thinking to submit to the Will of Allah with the main objective of pleasing Him. This paradigm elevates the spirit of relationship between Allah and human beings, human beings and human beings, and human beings with other creatures, based on two core values - trust (*amanah*) and justice (*'adl*). The concept of trust (*al amanah*) is a Divine commandment to accept the responsibility.

The ability to fulfill the trust (*al Amanah*) and obligatory duties (*al Fara'id*) is accompanied with the guidance and capability (Al Faruqi, p.5), as stated in *Sura Hud* 11: 6 and *Sura Az Zumar* 39: 41. *Sura Hud* 11 verse 6 proclaims that:

There is no moving creature on Earth whose sustenance is not provided by Allah. He knows its living and its resting place, and all that is recorded in a Glorious Book.

The immediate task that Allah prescribed to the Muslim society is to carry out the trust in bringing stability, harmony and tranquility. The task should be discharged collectively. In

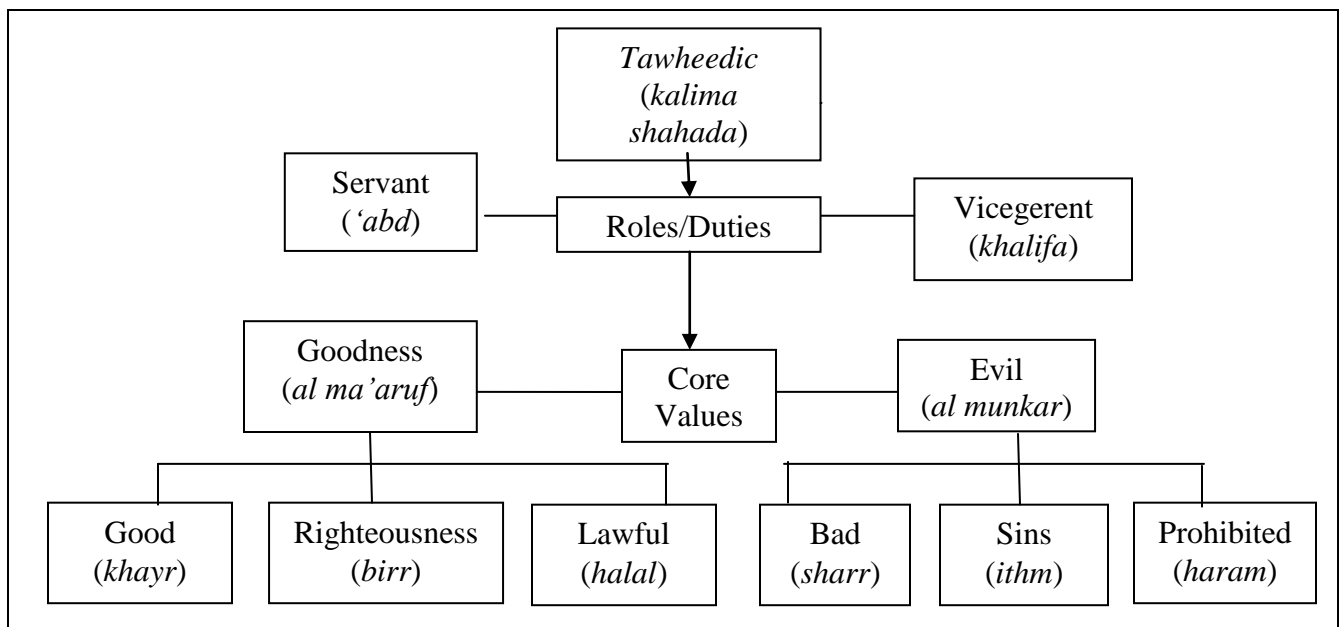
a *Hadith* (Muslim, 1998) Abu Hurayrah said that the Messenger of Allah (peace be upon him) said,

Whoever among you witnesses an evil, let him change it with his hand. If he is unable, then let him change it with his tongue. If he is unable, then let him change it with his heart, and this is the weakest faith.

The *Qur'an* and *Ahadith* of the Messenger of Allah (Peace be upon him) provide the fundamental references for man to live according to the Will of Allah. The recognition of the references prevails in the declaration of faith, also known as the *kalima shahaada* (لا إله إلا الله محمد رسول الله) which emphasizes that “*There is no god but Allah, and Muhammad is the messenger of Allah.*” The comprehensive conditions of the *kalima shahaada* signify its status as the foundation of the Islamic faith (*Tawheedic* paradigm). The *kalima shahaada* serves as the foundation of faith (*iman*) operating in the contexts of multiple relationships within the society (*mujtama'*). The execution of Islamic faith is a trust (*al Amanah*); thus, it must be done with justice (*al 'adl*). The fundamental principles of the Islamic worldview consist of (a) *tawheedic* paradigm, (b) vicegerency (*khilafah*), (c) servant (*'abd*), (d) trust (*amanah*) and (e) justice (*'adalah*) (Haneef, 1997, pp.44-49).

Figure 1 depicts three main components that Islamic worldview, namely (a) *Tawheedic* paradigm, (b) roles/duties, and (c) core values. The *Tawheedic* paradigm reflects true submission to Allah and absolute devotion to His Commandments. As a result of the recognition of *kalima shahaada*, man has to resume two fundamental yet inter-related roles – servant and vicegerent of Allah. The roles must be implemented with due diligence – trust and justice.

Figure 1: Fundamental Principles of Tawhidic paradigm



2.2 Strategic Planning

Strategic planning is a conceptual managerial task under highly pen-paper orientation with the limited data available. Chen, Ho and Kocaoglu (2009) define strategic planning as a managerial exercise into a conceptual process to develop a roadmap or milestone for the company to achieve a desirable goal through various means to optimize the future endeavors. The emphasis of strategic planning is to develop a conceptual framework on how a company could achieve better performance effectively and efficiently. According to Liedtka (2000), strategic planning provides a mental framework of preparation to change from one undesirable to a desirable situation. Strategic change framework is emphasised in this context. In other seminal work, Liedtka (2008) defined strategic planning as a process to formulate an authentic road map or strategy that reflects the reality. In other words, Liedtka (2008) argues that the strategic planning allows strategist to formulate a strategy that can bring the company closer to the reality in the future through various changes and adoptions of behaviour, decisions and actions. Wu, Liang, Yu & Yang (2010) define strategic planning as a process to determine the future outcomes through the analysis of the current reality that aligned with the targeted goals and the right organizational process.

Companies are using M&A as a strategic option to reap promised benefits. The benefits of M&As include ability to strengthen market power (Kamien and Zang, 1990), to exploit the economies of scale and scope (Röller et al., 2001), to access target firms' assets that are valuable to acquirers such as production capabilities or intangible assets (e.g. Jovanovic and Rousseau, 2002), to reallocate technology to more efficient uses (Jovanovic and Rousseau, 2008), to increase the incentives to perform R&D due to a reduced risk of spillovers to competitors (d'Aspremont and Jacquemin, 1988), and to correct for managerial inefficiencies and weak corporate governance mechanisms (Jensen, 1988; Jensen and Ruback, 1983).

2.3 Mergers and Acquisitions

Mergers and acquisitions (M&As) are actually corporate strategy used by various types of organizations from different industry sectors that involved capital, people and other resources. Balle (2008) argued that M&As are common strategy used by various organizations, companies and business units. A merger or an acquisition happens simultaneously, directly or indirectly. According to Wolf (2003), technically both terms are unique (different) but they share common characteristics. Samuels (2005) defined acquisition as a process of takeover in which the one who takes over (acquirer) gains the control of the acquired company (partially, entirely or just the management of the company). According to Nogeste (2010), M&As can be differentiated by three types, namely (a) acquirer oriented, (b) target oriented, and (c) integrated oriented. Firstly, the acquirer oriented initiated the acquisition for the sake of increasing shareholders' value and competitiveness. Steuer and Wood (2008) argued that this approach implied that the acquirer has intention to introduce high level of change on the acquired entity. Secondly,

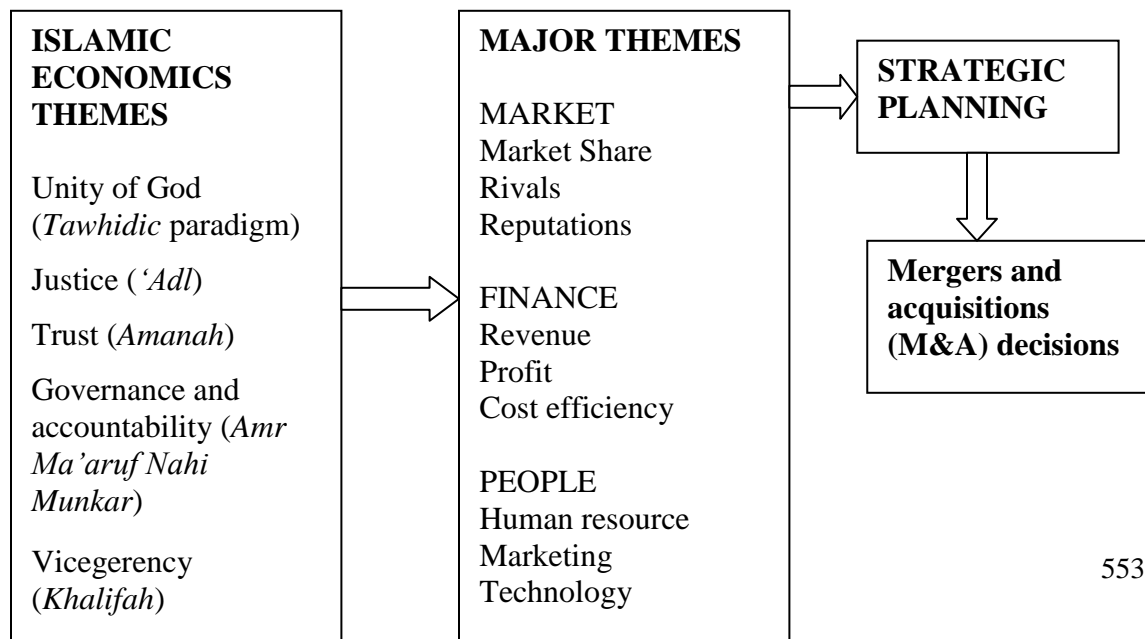
the target oriented initiated by the target organization as an offer to the acquirer. Finally, the integration oriented emphasises on the idea to enhance not only shareholders' value, but to acquire or exchange capabilities and competencies for better competitiveness and sustainability.

These are some of the challenges for M&A in construction industry. Firstly, the M&A is already a cost to the companies and it is expected by the shareholders that the M&A will boost their revenue base rapidly (Delaney and Wamuziri, 2004). The next problem is to create shareholders' value from the M&A exercises (Choi and Russel, 2004). According to Winch (1996), the M&A is not performing in the construction industry due to problem with its supply chain management. Stiebale & Reize (2011) argued that the M&A in the technical and technology sectors such as the construction industry is essential to support the continuous FDI.

Key success factors of construction industry include cost effectiveness, on-time project completion, and quality of completed projects (Chan & Chan, 2004; Othman, Hassan & Pasquire, 2004; Fiedler & Deegan, 2007; Jaafar, Ramayah, Abdul-Aziz & Saad, 2007). Construction firms with skills, competencies, good network, good human resource practices, and good corporate culture are able to reduce cost of construction, complete the projects on time and reduce the cost for liability defects (Alaghbari, A-Kadir & Ernawati, 2007; Nitithamyong & Tan, 2007; Luua, Caob & Parka, 2008).

Based on the above discussion, Islamic economics themes in strategic planning for M&A strategy are (1) Unity of God (*tawhidic*) paradigm, (2) justice (*'adl*), (3) trust (*amanah*), (4) promoting good governance-prevention eveil (*amr bil ma'aruf nahi anil munkar*), and (5) vicegerency (*khalifah*) that supported M&A strategy. While the major themes of strategic planning and M&A are (a) market (market share, rivals, and reputation), (b) finance (revenue, profit and cost efficiency), and (c) people (human resource, marketing and technology). Figure 2 depicts the framework of the study.

Figure 2: Framework of the study



3. RESEARCH METHOD

Previously, data collection methods are through analysis on secondary data instead of primary data. Gallet (1996) used longitudinal secondary data when the author examined the relationship between mergers in the U.S. steel industry and the market power. Choi and Russell (2004) investigated mergers and acquisitions in the construction industry through 171 transactions that occurred between 1980 and 2002. Yook (2004) examines the situation after the M&A of 75 largest acquisitions occurring during 1989 to 1994. Megginson et al. (2004) also used similar method on 204 M&As between 1977-1996. As for Yuce and Ng (2005), they investigated a sample consisting of all Canadian mergers that occurred between 1994 and 2000, on 1361 acquirer companies and 242 target companies. Kling (2006) argued that the macro level of M&A is a must. Heron and Lie (2002) investigated 959 M&As between January 1985 and December 1997. Choi and Harmatuck (2006) examined 44 mergers and acquisitions transactions occurring in the construction industry between 1980 and 2002. Yeh and Hoshino (2002) examined 86 Japanese corporate mergers between 1970 and 1994. Ramaswamy and Waegelein (2003) reported that the analysis on 162 merging firms from 1975 to 1990. Feroz et al. (2005) assessed 45 pairs only.

The study used qualitative research method, namely the personal interview method. The use of qualitative method is good because it can give detailed responses from the informants regarding the nature of M&A. According to Miles and Huberman (1994), qualitative method is appropriate and feasible to examine complex and difficult contexts of study because they can put the situation/s in question into the right perspective. In addition, Marshall and Rossman (1989) recommended the use of qualitative methods to enable researchers to explore the context of the study in greater detail. There are many techniques to get data using qualitative method, such as active or passive participation and observation, personal interviews, content analysis on various documents, and case study (Patton, 2002; Lee, 1999; Creswell, 1998).

4. RESULTS

The study interviewed 15 construction managers in the construction industry in Klang Valley areas as informants. There are three General Managers, Project Managers, Senior Manager and one Assistant General Manager, Business Development Manager, Contract Manager, Operations Manager, Project Engineer, and Site Manager. In terms of professional or education background, five informants are with accounting training (management accounting and financial accounting), three informants with economics background, three from business administration (including marketing and management), two in civil engineering, one in building engineering and another in structural engineering. Each interview consumed 20-30 minutes. The study used personal interview technique and note taking approach. Table 1 summarizes the informants' profile.

Table 1 Informants' profile

Code	Post	Professional/Educational background
CIP1	Project Manager	Management accounting
CIP 2	Contract Manager	Financial accounting
CIP3	Business Development Manager	Management accounting
CIP4	General Manager	Management accounting
CIP5	Senior Manager	Financial accounting
CIP6	Project Manager	Economics
CIP7	Operations Manager	Economics
CIP8	Site Manager	Economics
CIP9	Project Manager	Business Administration
CIP10	General Manager	Marketing
CIP11	Senior Manager	Management
CIP12	Project Engineer	Civil Engineering
CIP13	General Manager	Building Engineering
CIP14	Senior Manager	Structural Engineering
CIP15	Assistant General Manager	Civil Engineering

CIP = construction industry personnel

4.2 Questions

The informants were asked to provide Islamic concepts that they know best into the factors for and against the decisions for construction companies in Malaysia to go for M&A.

Factor 1

Most of the informants were very sure that the main reason for construction companies decided for M&A is to gain competitive advantage. PM1, PM2, PM4, PM6 and PM9 argued that M&A is very vital for their companies to gain competitive advantages. They relate the objectives to be profitable and sustainable in the business in line with the concept of trust and vicegerency in Islam. According to PM 1, as vicegerent in any company can undertake M&A, but whether they can make it or not, is not something that they could do without some thorough analysis. PM 1 said:

Some companies thought that by M&A they could gain better position in the market. With or without M&A, market can be expanded. In fact, construction companies need to consider whether they are able to expand their market share with greater resources combined with the other companies. If they can further expand the market share through M&A, then it's advisable for them to consider M&A.

In this regard, PM 2 and PM 4 contended that M&A could build strength to get more customers through the expansion of market share. The ability to expand the market share is related to the concept of sharing and caring, to provide services that needed by fellow

mankind However, being competitive does not mean construction companies can be always better off than their immediate competitors. PM 2 uttered:

In the free market, everybody is free to enter and leave the market. Construction companies are also in the same shoes. However, it is not easy for anybody to enter into this industry because it requires huge investment. Some kind of cost-benefit studies is required because at the end of the day... you know what I meant... dollars and cents. So, when you want to enter into M&A, you have to be extra careful.

When PM 2 commented competitiveness as the main reason for M&A in construction industry, PM 4 argued that the competition is an on-going affair. PM 4 said:

The M&A talks are not seasonal. The ups and downs of the economy could influence the seriousness of the talk about M&A. At least, such talk is on-going.

As for PM6, construction companies are very sensitive with cost of materials because this factor is important to determine a competitive price. PM 6 said:

In M&A, companies always wanted to reduce or minimize the cost. However, construction companies are expensive because they use big machine and tools. Construction companies need to consider based on the cost of production.

As for CM1, construction companies decided to merge or to acquire or both are on basis of financial performance and the size of the project. CM 1 said:

I used to work in big construction company. This company was acquired by another medium construction company for very simple reason that was to be big enough to perform and complete the projects. Prior to the decision, this company has financial problem, they could not pay salary to their employees, they have been annoyed by debt collectors to pay debt, and so forth. Before it went into worst situation, the managing director has arranged with its own rival. Of course, he said that it is not easy for him to do so. Just imagined, he is the boss of this small company. What could happen to him once his small company is being acquired by a medium company? Will he hold the position of managing director? Of course, a big No! You know what happened to him now? He is just a project manager.

CM 2 argued that some construction companies decided to mergers and acquisitions is not solely for the sake of better financial performance, but other non financial reason such as the provision of employment continuity. CM 2 uttered:

I used to work in a company in Shah Alam, quite established construction company and involved in many multi millions ringgit of property development projects in 1990s. The 'luxury' was not long lasting due to sharp drop in getting new projects. However, the company already hired many employees due to several projects that they obtained. If the company were to continue the business as usual, it would have to lay off many employees. Since acquirer company was also an established company with good reputation, when M&A with it, the workers would not worried about to find another job.

According to CM3, M&A is just another corporate strategy to ensure the sustainability of the business. CM3 said:

I see this M&A as purely corporate strategy. It is in the hands of the top management and board to decide. Looking at the current performance of many construction companies, they could not stand lonely, especially now, the open door policy allows foreign construction companies to do construction projects. It is good for construction companies to merge with others or let them be acquired by others. In business, there should not be a room for nostalgia or emotional sentiment. Even though the company was established by our family, when there is a need to merge with others, we need to opt for it. Our business must go on with higher profit and to give more dividends to the shareholders.

CM4 also argued that the M&A is good corporate strategy to expand globally, particularly in the age of globalization. CM 4 explained:

I have seen many construction companies merged, especially when they wanted to bid construction projects in overseas. If a construction company were to bid alone, it might not be able to convince the project owners that could complete the project.

Factor 2

Some construction companies foresee cost advantages through M&A. PM 1 said:

If the companies can reduce the cost of operations through the M&A, then they can consider adopting the M&A strategy. Sometimes M&A can be costly when they are not carefully planned or sometimes things are done on ad hoc basis.

Cost saving is essential in construction companies. If they were able to obtain financial support from non bank, that will be good. CM 1 said:

The price of materials is very important. If the project is costly, then there is no use of completing construction projects. This is the right time to opt for M&A, so that the new company will have more money to buy construction materials in bulk at cheaper price and with cash. This approach will help the company to save some cost.

The cost component needs serious attention. According to PM2, in any M&A, cost factor is always in the top priority list. PM 2 argued:

... the overall total costs that will be incurred for M&A with other companies must be determined to estimate gain/profit.

PM4 also contended that cost is vital in the construction industry due to its huge cost of investment. PM 4 said:

Cost available should be considered in order for the company if they want to adopt M&A. The cost must be enough to cover the cost of M&A.

PM6 has always emphasised on the cost cutting approach through M&A. PM 6 articulated:

When people decided to be in construction business, they had done the cost-benefit, whether they can make profit or not. But one thing is needed is continue to invest in the company. Yes, cost cutting is important, but the new investment is very important for construction companies. Construction companies need to consider based on the cost of production.

Cost is important. PM9 argued:

To acquire other company, costs need to be considered depend on condition of targeted. Without strong financial positions, acquisition can cause problem from bad to worse.

Factor 3

The informants were excited to mention the third factor for the favor of M&A in the construction industry. According to PM 2, the reputation of the companies is important. PM 2said:

The reputation of the companies that we want to M&A with must have good reputation because later it will affect the firm.

PM 3 said:

M&A is to gain the trust of the client. If they had failed so many times, it will affect their performance.

PM 7 argued:

The similarities that the companies have will help both to decide to merge or to acquire. Thus, it is important to have the basic knowledge on M&A.

Factor 4

PM 1 argued that the motivation to perform M&A is guided by the bottom line of the company. PM 1 uttered:

M&A comes with cost, but sometimes M&A is good when it can increase the profit quickly. After all this is a strategy to get bigger and stronger so that competitors will have to work harder.

While PM 1 emphasizes on the motivation and material incentives, PM 2 underscored the importance of being cost efficient to avoid being disadvantaged. PM 2 mentioned:

M&A gives the opportunities and advantages to have efficient production with high technology.

In some situations, PM 4 thought that motivation is internally oriented; the capability to perform the M&A is really required expertise. PM 4 supposed:

Expertise need to be considered as the company might be able to exchange the expertise from other firm through M&A.

Factor 5

PM 5 argued that some companies use M&A in order to be profitable. PM 5 said:

If the company is not doing well, M&A will be a good option.

However, PM6 argued:

A construction company needs to consider which strategy gain more profit.

Factor 6

This factor is important for construction companies before they go for M&A.

According to PM 5, financial capability is an enabler for M&A. PM 5 said:

If there is an excess capital, the company may merge or acquire with another company.

PM 8 shared similar sentiment when comes to money matters. PM 8 stated:

Financial condition is important. A bad performance of financial condition will lead other companies to lose interest to merge. Likewise, the size of the company matters too. If the company’s size is small, it is a good way to choose M&A.

The nature of construction companies is highly capital intensive and requires very frequent investment. PM 10 said:

Many construction projects are in need of huge capital, so M&A is one of the solutions. Moreover, construction projects need expertise from many fields. So M&A provide pool of expertise.

For PM 11, the environmental scanning and industry analysis are very important to diagnose the health of a company. PM 11 said:

Always do SWOT analysis to understand the future risk and opportunities. This way they have more chances to gain more customers and eliminate their competitors.

Table 2 summarises the feedback of the informants on the factors that supported for M&A in the construction industry.

Table 2: Summary of feedback “for” M&A with Islamic economic themes

Factors	Quotes from the respondents	Islamic Economics Themes	Responded by
1	<i>“...gain better position ...”</i>	Trust	PM 1
	<i>“...huge investment...”</i>	Justice	PM 2
	<i>“...talk about M&A...”</i>	Governance	PM 4
	<i>“...reduce or minimize the cost...”</i>	Governance	PM 6
	<i>“...to be big enough to perform and complete the projects...”</i>	Vicegerency	CM1
	<i>“...not long lasting...”</i>	Justice	CM2
	<i>“...must go on with higher profit...”</i>	Justice	CM3
	<i>“...bid construction projects.”</i>	Trust	CM4
2	<i>“...reduce the cost of operations...”</i>	Justice	PM 1
	<i>“...costs that will incur for M&A...”</i>	Trust	PM 2
	<i>“...huge cost of investment...”</i>	Justice	PM 4
	<i>“...cost cutting approach...”</i>	Trust	PM 6

	“...costs to be considered...”	Trust	PM 9
	“... price of materials is very important...”	Justice	CM1
3	“...reputation of the companies...”	Vicegerency	PM 2
	“...trust of the client...”	Trust	PM 3
	“...similarities...technology....”	Trust	PM 7
4	“...increase the profit quickly...”	Vicegerency	PM 1
	“...opportunities and advantages...”	Vicegerency	PM 2
	“...expertise (human resource)...”	Tawhidic view	PM 4
5	“...good option (revenue)...”	Governance	PM 5
	“...strategy gain more profit...”	Trust	PM6
6	“...excess capital (financial)...”	Vicegerency	PM 5
	“...financial condition...”	Trust	PM 8
	“...expertise [of](technology...”	Trust	PM 10
	“...future risk and opportunities (market share)...”	Governance	PM 11

The informants provided six factors favoring the decisions for construction companies to go for M&A. However, the six factors can be regrouped into several themes in the strategic planning of mergers and acquisitions in the construction industry. The most important themes for M&A are “R2 financial resource” (n=11) and “C3 reputation” (n=3). Based on the respondents’ background, all backgrounds voted for “R2 financial resource” as the main theme in M&A for construction industry. However, for “C3 reputation”, all the respondents came from “accounting” background. The Islamic economic themes results in trust (n=10), justice (n=6), vicegerency (n=5), governance (n=4) and *Tawhidic* view (n=1).

5. CONCLUSION

Islamic economics themes in strategic planning for Malaysia’s higher education are trust, justice, vicegerency and governance and accountability. The results of personal interviews gave five Islamic themes, namely (1) Unity of God (*tawhidic*) paradigm, (2) justice (*‘adl*), (3) trust (*amanah*), (4) promoting good governance-prevention eveil (*amr bil ma’aruf nahi anil mungkar*), and (5) vicegerency (*khalifah*) that supported M&A strategy. In terms of practical implications, this study facilitates strategists or planners with common guidelines to plan strategically for M&A. The study suggests the future research to use mixed method (questionnaire survey and personal interview) and include more informants, particularly industry key stakeholders.

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