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Conglomerate Business Model: The Case of IJM Corporation Berhad

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Abstract: Since the early 21st century, the globalization trend and technological innovations have changed the ways and speed of market growth. Rapid market expansion and the pressure for firms to achieve sustainable business growth via mergers and acquisitions have become the norms for acquiring the necessary competencies, expanding market shares and business integrations. This study explains the factors that correlate to the IJM's financial performance based on the market dynamics in recent years. This case study is a qualitative approach employing systematic review and content analysis. As a result, firms begin to diversify or venture into the business segments that might be related to or complement their core businesses, intentionally or unintentionally, which eventually evolved into the conglomerate form. This case study provides a financial performance analysis of IJM Corporation Berhad's success and challenges from its conglomerate business model. The fact that a well-diversified firm will have better risk management in the event of an economic downturn is also a primary driver for firms to embark on a corporate diversification strategy. This case study reveals IJM's conglomerate model has been successful during its rapid business growth; however, it has shown signs of diminishing in recent years.

Keywords: management; financial performance; corporate diversification; capital structure; conglomerate; business model

Introduction

Founded in 1983 by a merger between three medium-sized local construction companies—IGB Construction Sdn Bhd, Jurutama Sdn Bhd and Mudajaya Sdn Bhd, IJM Corporation Berhad (IJM) is a holding corporation that specializes in construction and investments. At the point of this study, its principal activities are divided into five major business divisions (Figure 1), namely: 1) Industrial Manufacturing, 2) Infrastructure, 3) Property Development, 4) Construction and 5) Plantation. The company provides building services for many types of infrastructure, including highways, roads, bridges, airports, trains, commercial and cultural complexes, preservation and refurbishing projects, condominiums, resorts, hotels, clubs, and club road pavements. In addition, it carries out the construction of prefabricated buildings, medical facilities, electricity projects, oil and gas projects, and water supply projects. Headquartered in Petaling Jaya, Selangor, Malaysia, the organization has established a growing presence over the last three decades with operations spanning several countries, including Malaysia, China, India, Chile, the United Arab Emirates, Pakistan, Argentina, Indonesia, Vietnam, Singapore, and the United Kingdom. IJM is (Figure 2).



Figure 1. Principles Activities of IJM Group. Source: IJM Annual Report (2019).

In 1988, IJM became a public-listed company with a market capitalization of RM66 million and total assets of RM172 million. In 2008, IJM acquired the Road Builder Group to augment its position as one of the country's biggest construction companies. At one point, the Group consisted of 4 publicly listed companies, of which two were privatized during the 2000s–2010s with the rationale of leveraging IJM's financial standing and resources to undertake larger-scale projects in the future. Its market capitalization stood at RM7.98 billion, with total assets of RM23.66 billion as of September 2019, with over 4,800 employees worldwide. Based on the 2019 annual report, the top 30 shareholders are all institutional investors, making up 62.1% of the total shareholdings. The profile of these institutional investors is generally sovereign funds, trust/mutual funds, and asset management companies, making IJM one of the few genuinely public-owned conglomerates in the Malaysia Stock Exchange, separating shareholders and its management independently.



Figure 2. IJM Group's Global Presence. Source: IJM Annual Report (2019).

The concept of conglomerate discount argues the firm's valuation of a diversified group tends to be less than the sum of its parts (Lang & Stulz, 1994; Berger & Ofek, 1995) due to the tendency of a diversified firm's inability to manage the complexity of different businesses as compared to a single business-focused firm. However, some studies suggest that the conglomerate discount may not be due to the firm's inefficiency in management (Maksimovic & Phillips, 2007). Although recent decades indicate a trend that the conglomerate model has failed primarily in the developed economy, it is also noted that the conglomerate model appears to be successful in the Asian context, especially the emerging economies (Khanna & Palepu, 1997).

Literature Review

Background of the Company (IJM)

The IJM Corporate Evolution:

Since IJM's inception more than three decades ago, IJM has experienced 3 phases of corporate development:

1. **Corporate Merger 1.0**—The need for growth & consolidation of resources to compete effectively in the industry.
2. **Corporate Merger 2.0**—Strategic business entry and market consolidation
3. **Organizational Consolidation Phase**—Privatizing two public-listed subsidiaries to gain a competitive advantage by strengthening its financial and competencies resources to take on larger projects.

Through its corporate development, IJM experienced rapid growth, and the market capitalization has enhanced substantially over 120 times compared with its initial public offers position.

However, since 2015, it is also noted that the share price of IJM has decreased severely (Figure 3). It lost more than 50% of its market capitalization compared to its peak in 2015.



Figure 3. IJM Share Price Trend 2015–2020. Source: Bloomberg (2020).

Overview of Malaysia Economic Landscape 2015–2019

Central Malaysia's economic sectors generally achieved moderate growth, except for the mining sector. The moderation resulted in the slower expansion of activity in industries catering to domestic demand. Headline inflation declined to a 2.0% level in 2015 and 2016 as the lower global energy and commodity prices effect are more severe to offset the impacts from a weaker ringgit exchange rate, the implementation of Goods Service Tax (GST) and the upward revisions in controlled items prices. Despite the lower inflation during the fiscal year, price increases were rather pervasive due to the implementation of GST and the weakening of the ringgit. Headline inflation was also relatively more volatile in 2015, reflecting a series of adjustments in domestic fuel prices (BNM, 2016).

In 2017, The Malaysian economy rebounded strongly, achieving 5.9% growth. Growth was driven by domestic demand, reflecting faster expansion in both private and public sector spending. Like the rest of Southeast Asia, Malaysia benefited from the general global recovery and witnessed its gross exports increase the fastest since 2004. The year's inflation remained volatile, mainly affected by higher domestic fuel prices. Increasing external and internal costs from rising global commodity prices and disruptions in local food supplies also contributed to inflation during the year.

In 2018, the Malaysian economy subsequently encountered several external and domestic challenges. Policies and political shifts, arising partly from the global trade tensions and the change of government in Malaysia, became factors of uncertainty for the economy. Unanticipated supply disruptions in the mining and agriculture sectors and commodity exports adversely affected Malaysia's economic performance, resulting in a larger-than-expected moderation in growth.

Malaysia's economic growth for 2019 was at 4.3%, underpinned by the continued robust growth in private consumption amid stable labour market conditions based on the World Bank report. The adverse external factor, such as the impact of the US-China Trade War, is anticipated to persist over a long period, with heightened uncertainty surrounding the economic environment and weak global demand for electronics and electrical products affecting export growth. Construction sector growth remains challenging and soft in 2019, with a mere increase of 0.1% (Exhibit 4.0).

While private consumption has remained resilient, overall economic activity has been weighed down by softer-than-expected investment growth and weakening export demand. Investment activity is projected to remain soft soon, with both public and private sectors continuing to be cautious towards capital spending.

Despite the subdued outlook, the Malaysian government continued to be committed to its fiscal consolidation plan, expecting a 3.4 per cent fiscal deficit target to be achieved in 2019. Despite low consumer price inflation, the rising cost of living continues to persist among the public and the government. Shortages of affordable housing supplies, the extent of household debt, lagging wages in specific sectors and higher-than-average food price inflation remain the main issues concerning the nation.

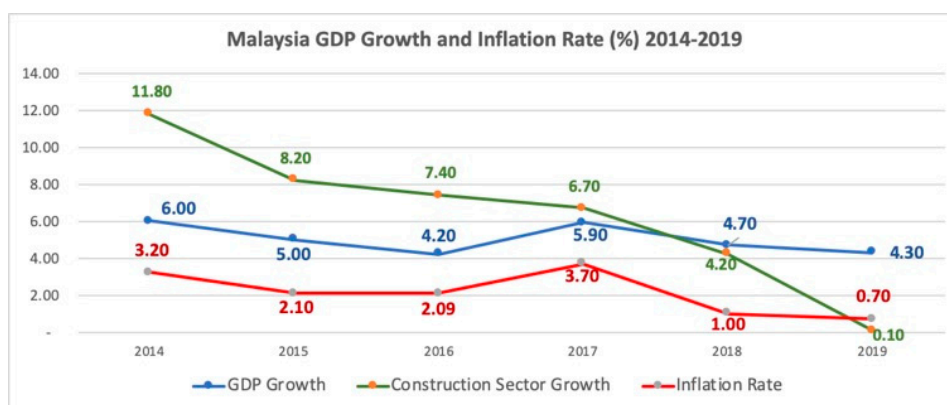


Figure 4. Malaysia GDP Growth and Inflation Rate Trend 2014–2019. Source: Bank Negara Annual Report, 2014–2019.

Methodology

This comprehensive evaluation of the pertinent literature included a narrative synthesis. Narrative synthesis aims to summarise and clarify the synthesis results by applying academic writing (Kok, 2023; Kok & Siripipatthanakul, 2023, a). The qualitative research methodology includes four steps: developing a research plan, acquiring data, analyzing data, and producing reports. Content analysis is a qualitative technique that employs verbal, visual, or written data to systematically and objectively describe a given phenomenon (Jaipong et al., 2023). As a consequence, content analysis facilitates the development of credible findings. In addition, it is a flexible data analysis technique that can be applied to systematic qualitative reviews (Limna, P., & Kraiwanit, 2022). Conducting periodic qualitative evaluations must modify or adapt content analysis methods to be compatible with highly organized and contextualized information to locate knowledge and theory. In conclusion, qualitative content analysis was utilized in the current study (Kok & Siripipatthanakul, 2023, b & c; Limna et al., 2022; Jaipong et al., 2022; Viphanphong et al., 2023).

Results

Malaysia Construction Sector Business Outlook 2015–2018

Since 2014, the Malaysian construction sector has been experiencing a slowdown in growth rate, mainly affected by uncertainties in both domestic and external factors. The general spending in the construction sector is highly dependent on public expenditure. In 2015, the construction industry saw a reduction of 23.2% in project values compared to 2014, mainly due to the slowdown in the private sectors and non-residential and infrastructure segments.

Number of Public and Private Sector Projects

Sektor Sector	2011	2012	2013	2014	2015	2016	2017	2018
Awam Public	1,954	2,001	1,971	1,800	1,902	2,188	2,328	1,093
Swasta Private	5,771	5,997	6,228	6,276	5,653	6,042	6,046	4,915
Jumlah Total	7,725	7,998	8,199	8,076	7,555	8,230	8,374	6,008

Figure 5. Public and Private Sector Projects 2011–2018. Source: CIDB Annual Report (2018).

Number of Projects by Category

Sektor Sector	2011	2012	2013	2014	2015	2016	2017	2018
Kediaman Residential	2,253	2,307	2,365	2,321	2,096	2,168	2,177	1,636
Bukan Kediaman Non Residential	2,661	2,884	3,075	3,019	2,697	2,898	2,971	2,310
Kemudahan Sosial Social Amenities	820	918	731	702	727	917	929	610
Infrastruktur Infrastructure	1,991	1,889	2,028	2,034	2,035	2,247	2,297	1,452
Jumlah Total	7,725	7,998	8,199	8,076	7,555	8,230	8,374	6,008

Figure 6. Construction Projects by Category 2011–2018. Source: CIDB Annual Report (2018).

In 2016, to foster sustainable growth for the construction industry, the government introduced the Construction Industry Transformation Plan (CITP), a blueprint to transform the construction industry from 2016 to 2020. The Plan aims to revamp the construction industry through four strategic thrusts: Quality, Safety and Professionalism, Environmental Sustainability, Productivity and Internationalisation. In the same year, the industry witnessed a rebound in terms of projects awarded, with the main contribution from the infrastructure segment, which is part of the 11th Malaysian Plan.

New projects in the public transports system (Figure 7), oil & gas downstream infrastructure and water-related projects such as Klang Valley Mass Rapid Transit Line 2, Klang Valley Light Railway Transit (KVLRT) 3, rail-related construction jobs and new highways—Damansara-Shah Alam Highway (DASH), the Sungai Besi-Ulu Kelang Elevated Expressway (SUKE), and the balance of West Coast Expressway (WCE) packages were awarded. In East Malaysia, the 1,090 km Pan-Borneo Highway was awarded as well. For the oil and gas infrastructure, Petronas' Refinery and Petrochemicals Integrated Development (Rapid) project in Pengerang, Johor, saw investments worth RM18bil based on Budget 2016. The public sector projects accounted for 79.2 of the 2016 project values.

MAJOR INFRASTRUCTURE			
PROJECTS	LOCATION	COMPLETION YEAR	REMARKS
RAIL			
East Coast Rail Link (ECRL)	Port Klang, Selangor - Kota Bharu, Kelantan	2026	Dungun to Mentakab Section - under construction
Electrified Double Track Project (EDTP) Gemas-Johor Bahru	Gemas - Johor Bahru	2021	Under construction
Rapid Transit System (RTS)	Bukit Chagar - Woodlands, Singapore	Beyond 2024	Revised and subject to the Government's confirmation
LRT Line 3	Bandar Utama - Klang	2024	Under construction
MRT 2 (SSP Line)	Sungai Buloh - Putrajaya	2022	Under construction
HIGHWAY/EXPRESSWAY			
Damansara-Shah Alam Highway (DASH)	Sungai Penchala - Shah Alam	2020	Under construction
East Klang Valley Expressway (EKVE)	Sungai Long - Ukey Perdana	2020	Under construction
Lebuhraya Putrajaya-KLIA (MEX II)	MEX - KLIA - KLIA 2	2020	Contract awarded
Pan-Borneo Highway	Tawau - Kuching	2022/2023	Under construction
Sungai Besi-Ulu Kelang Elevated Expressway (SUKE)	Sungai Besi - Cheras - Ampang - Ulu Kelang	2020	Under construction
West Coast Expressway (WCE)	Taiping - Sabak Bernam - Banting	2022	Completed section 5, 9, 10
OTHERS			
West Port Expansion (380 acres land under the sea)	West Port, Port Klang	2040	Under construction (2 terminals to be completed by 2021)

Figure 7. List of Malaysia's Major Infrastructure Projects. Source: CRBE WTW, Malaysia Real Estate Market Outlook (2020).

In 2017, public sector projects continued to dominate the construction industry, which accounted for 69.1% of the total project value. A slower growth rate was anticipated due to the mega projects' main packages awarded in 2016. However, as the year progressed, the sector was further dampened due to the Malaysian government's reprioritization of mega infrastructure projects to rationalize the fiscal position.

As the global economy uncertainties escalated, growth in the construction sector eventually moderated to 4.2% in 2018. The moderation was due to a slowdown in the property segment. The higher levels of unsold residential properties and the oversupply in commercial property weighed on growth in the residential and non-residential sub-sectors, respectively. Nevertheless, the civil engineering sub-sector remained the critical driver of growth for the construction sector, supported by the continued progress of large petrochemical, transportation, and utility projects. The special trade sub-sector benefited from early works activity of large transportation projects and additional support from solar projects.

As of December 2018, 6,008 projects worth RM106.6 billion were recorded, compared to 8,374 projects worth RM198.5 billion in 2017 (Figures 5, 6, 8 and 9). The decline in project volume and value by a sharp 29.2% Year-on-Year (RM150.6 billion) was due to the new government regime reviewing the major contracts as priorities need to shift tremendously to ensure balanced, sustainable growth.

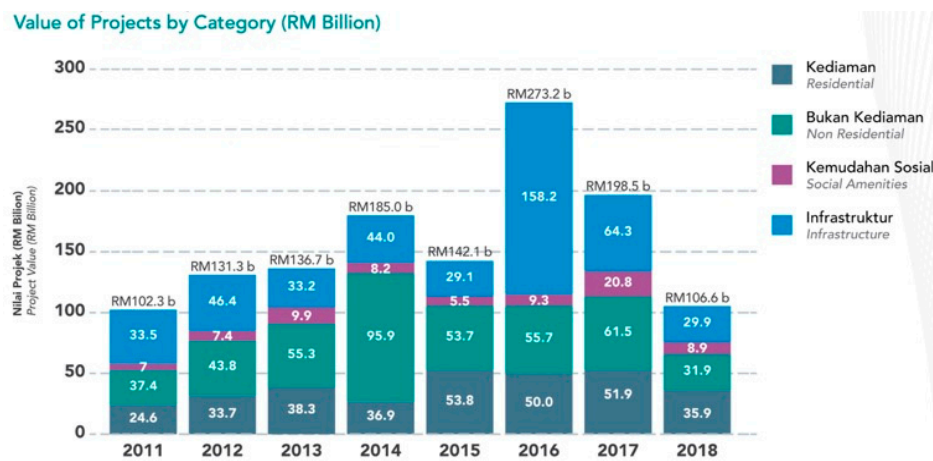


Figure 8. Value of Construction Projects by Category 2011–2018. Source: CIDB Annual Report (2018).

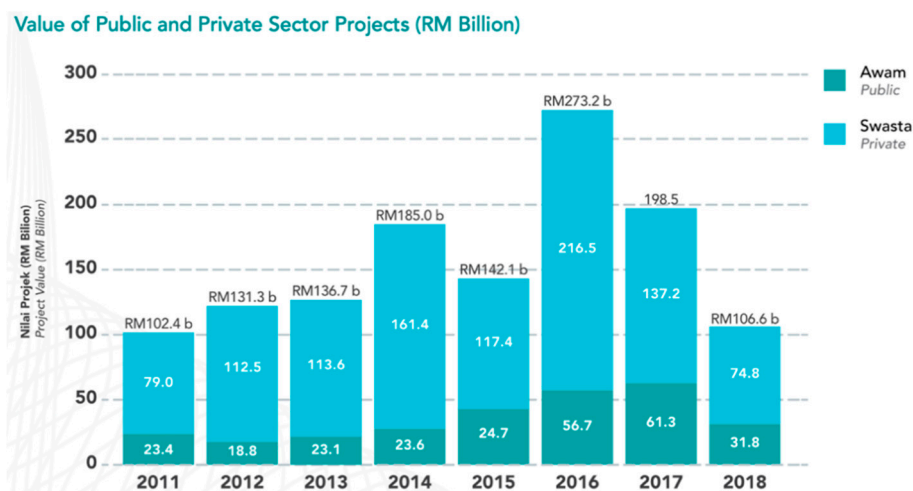


Figure 9. Value of Construction Projects by Public and Private Sector 2011–2018. Source: CIDB Annual Report (2018).

Economic Transformation Programme (ETP)

ETP was an initiative introduced by the Malaysian government in 2010. It aims to improve the country's scenario by developing the national infrastructure sector. The ETP identifies 12 National Key Economic Areas (NKEA), primarily focusing on the oil, gas, energy, and infrastructure sectors. These sectors are chosen based on their contribution to the national economy and the essence of these sectors towards accelerating the country's future growth as an emerging market. The program has attracted massive investments from national and international investors in the construction sector.

Introduction of Goods Service Tax (GST)

In April 2015, GST was a new consumption tax levied on goods and services supplied at each stage of the supply chain, from the supplier to the retail location of the distribution. GST paid on business inputs is claimable. GST has become a broad-based consumption tax that covers all sectors of the national economy. The fundamental of GST is its self-policing features which enable businesses to claim input tax credits by automatic deduction in their accounting system. GST is charged at 6 per cent of the value of supply.

The reception of GST was generally unpopular (Ling, Osman, Arman, A. B., Muhammad Safizal, & Rana, 2016). Post Malaysia 14th General Election, the new government of Pakatan Harapan reduced it to 0% on 1 June 2018. A higher cost of living has been observed since its implementation, which resulted in lower domestic consumption (BNM, 2016). GST was eventually repealed by July 2018 and later replaced with the Sales Tax and Service Tax (SST), a single-stage tax levied on goods that are imported and locally manufactured, either at the time of importation or the goods are sold or otherwise disposed of by the manufacturer at the rate of 6 per cent on September 2018.

Post Malaysia 14th General Election Aftermath

In May 2018, the result of the General Election witnessed the first change in the government of Malaysia over the last 60 years. The new administration manifesto that focuses on reducing the burden on people's cost of living, battle against corruption and transparency over government tenders has seen changes and impact on the construction industry and infrastructure concessions. Several mega infrastructure projects were on hold, reviewed and cancelled. IJM's construction and highway concessions were affected by the termination of the RM 1.13 Billion Light Rail Transit LRT 3 underground contract and government pressure to reduce the highway toll rate.

Coronavirus (Covid-19) Pandemic Impact

The impact of the COVID-19 pandemic on the global economy is significant. The effect of the worldwide stock market and oil price crashes has put the global economy into recession mode. The decline marked the highest setback since the 2008 Global Financial Crisis. Global lockdowns by many nations to contain the spread of the pandemic in the world have led to economic contractions. Malaysia's Gross Domestic Product (GDP) growth is projected between -2% to 0.5% in 2020 against a highly volatile global economic outlook due mainly to the COVID-19 pandemic (BNM, 2020). Malaysia's economy suffered the same fate due to low global demand, supply chain disruption, low tourism receipts and lower domestic income due to the domestic containment measures, namely Movement Control Order (MCO), since Mid-March 2020.

The ongoing COVID-19 pandemic has significantly impacted global economic growth prospects, with the outlook heavily contingent on countries' ability to contain the pandemic over the remainder of the year successfully. The International Monetary Fund (IMF) is anticipating a recession in 2020 that is at least as bad as during the global financial crisis in 2009 and is projecting a recovery in 2021. According to Bank Negara Malaysia (BNM), Malaysia's domestic growth is expected to remain susceptible to a recurrence of commodities supply shocks and continued low commodity prices,

which could pose additional risks to production in the commodities sector, exports and income growth (Figure 10).

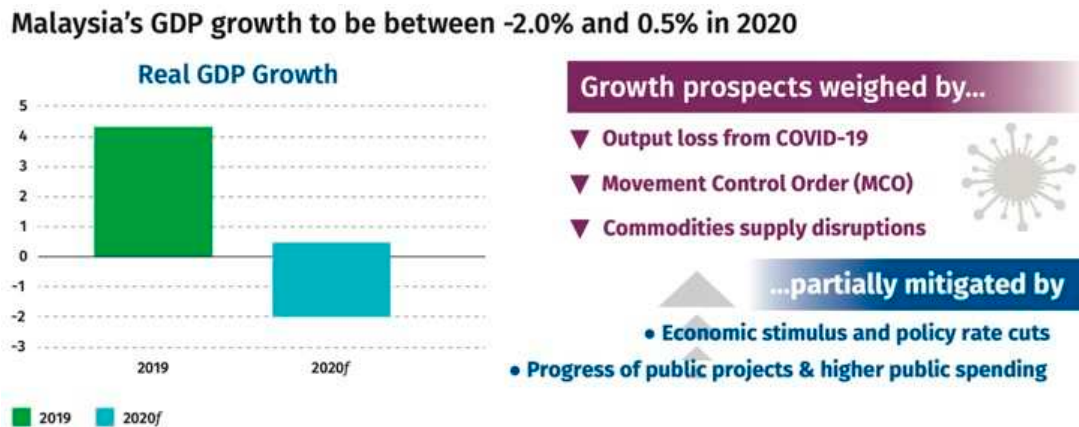


Figure 10. Highlights of Malaysia's Economy Outlook 2020. Source: BNM (2020).

The federal government has implemented various economic stimulus measures (Figure 11).

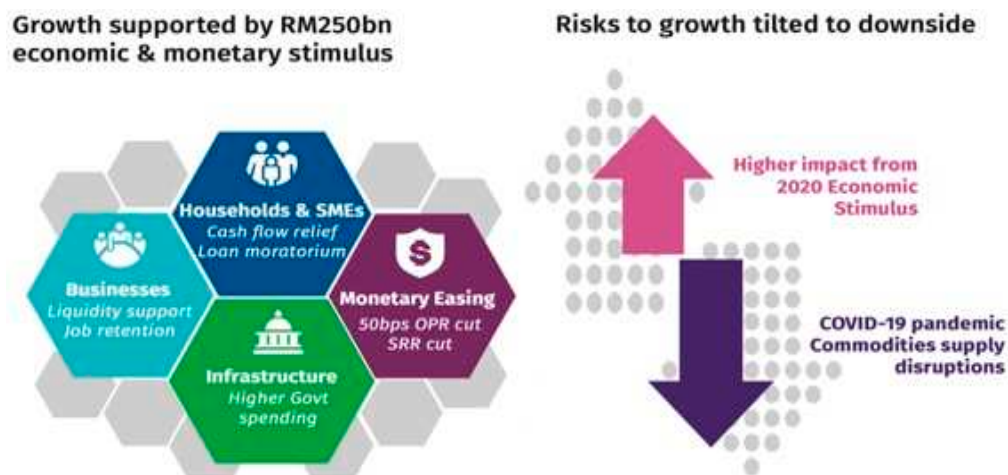


Figure 11. Economic Stimulus Measures Overview. Source: BNM (2020).

Key Challenges Ahead

(1) Undervalued Market Capitalization against Book Value: Shareholders' Perception on IJM Business Outlook

In general, the business environment has been challenging, coupled with profit margins under pressure, resulting in diminishing Return on Equity (ROE). These setbacks contributed to IJM's declining share price over the years (Figure 12).

The ROE ratio is the profitability ratio that measures the ability of a firm to generate profits from its shareholder's investments in the firm and how efficiently a company will use their money to generate net income. ROE is also an indicator of management's effectiveness in deploying equity financing to fund operations and grow the company. In FYE2019, the ROE has deteriorated by almost half compared to FYE2016

The declining ROE, the slower industrial growth outlook and the softened revenue and order book contributed to the decline of IJM's share price, leading to the undervalued Price to Book (P/B) ratio. While IJM's fundamentals at the point of the case study do not suggest a going-concern scenario, however, the interpretation of the low P/B ratio might potentially indicate the low confidence level of the future company outlook and the management effectiveness in managing the equity resources as implied by the company's ROE performance.

IJM KEY FINANCIAL HIGHLIGHTS 2015-2019						IJM KEY FINANCIAL HIGHLIGHTS 2015-2019					
	In RM Billion						2015	2016	2017	2018	2019
Operating Revenue						Order Book (Construction)	7.00	7.55	8.50	9.41	7.80
Construction	1.22	1.64	2.53	2.68	2.33	EBITDA	1.16	1.59	1.46	1.16	1.21
Property Development	2.20	1.29	1.52	1.26	1.48	Profit/(Loss) Before Tax	1.02	1.16	1.01	0.61	0.65
Manufacturing & Quarrying	0.93	0.98	1.14	1.06	0.89	Profit/(Loss) After Tax	0.71	0.88	0.77	0.38	0.44
Plantation	0.67	0.56	0.75	0.75	0.63	Total Borrowing	6.15	5.84	6.00	5.91	6.66
Infrastructure	1.03	1.30	0.98	1.00	0.94	Finance Cost	0.24	0.17	0.14	0.19	0.23
Investment & Others	0.01	0.01	0.00	0.00	0.00	Shareholder Fund	8.43	9.03	9.50	9.35	9.54
	6.06	5.78	6.92	6.75	6.27	Total Assets	19.73	19.84	20.89	21.23	23.00
						Market Capitalization	10.80	12.65	12.29	9.72	8.05
Profit/(Loss) Before Tax						EBITDA (%)	19.1%	27.4%	21.1%	17.2%	19.3%
Construction	0.19	0.17	0.22	0.22	0.17	PBT Margin (%)	16.8%	20.1%	14.6%	9.1%	10.3%
Property Development	0.50	0.16	0.30	0.12	0.20	PAT Margin (%)	11.7%	15.2%	11.1%	5.6%	7.0%
Manufacturing & Quarrying	0.13	0.12	0.14	0.08	0.06	Gearing Ratio	50.3%	46.1%	40.6%	47.6%	53.5%
Plantation	0.09	0.05	0.17	0.05	(0.04)	Return on Total Assets	2.44%	4.00%	3.13%	1.63%	1.82%
Infrastructure	0.04	0.56	0.06	0.12	0.27	Return on Equity	5.71%	8.79%	6.88%	3.71%	4.39%
Investment & Others	0.08	0.10	0.12	0.01	(0.01)	Fin.Cost to Debt (%)	3.9%	2.9%	2.4%	3.1%	3.4%
	1.02	1.16	1.01	0.61	0.65	Price to Book	1.28	1.40	1.29	1.04	0.84
						NTA Per Share	5.62	2.52	2.63	2.58	2.63
Operating Revenue Contribution						Share Price					
Construction	20.2%	28.4%	36.6%	39.7%	37.1%	High	3.65	3.75	3.65	3.60	2.98
Property Development	36.3%	22.3%	21.9%	18.7%	23.6%	Low	3.05	2.87	3.07	2.55	1.39
Manufacturing & Quarrying	15.3%	17.0%	16.4%	15.7%	14.1%	Close	3.60	3.53	3.40	2.68	2.22
Plantation	11.0%	9.6%	10.9%	11.1%	10.1%						
Infrastructure	17.0%	22.4%	14.1%	14.9%	15.0%						
Investment & Others	0.2%	0.3%	0.1%	0.0%	0.0%						
	100.0%	100.0%	100.0%	100.0%	100.0%						
Profit/(Loss) Before Tax Contribution											
Construction	18.2%	14.8%	21.4%	36.1%	26.9%						
Property Development	48.6%	13.8%	30.0%	19.8%	31.2%						
Manufacturing & Quarrying	12.3%	10.7%	14.1%	13.5%	9.1%						
Plantation	8.8%	4.3%	16.7%	8.3%	-6.7%						
Infrastructure	4.1%	48.1%	6.2%	20.1%	41.3%						
Investment & Others	8.1%	8.3%	11.6%	2.1%	-1.9%						
	100.0%	100.0%	100.0%	100.0%	100.0%						

Figure 12. IJM Financial Performance 2015–2019. Source: IJM Corporation Berhad, Annual Report (2019).

The question of management effectiveness on resource allocation might be one of the reasons contributing to shareholder concerns. In FYE 2019, RM8.8 Billion was invested in Inventories (Figure 13), which accounted for approximately 38.3% of IJM's total assets. 84% of the inventories are related to Property Development Business. The Group's stocks to revenue ratio are 1.41 times and 5.91 times at the property development segment level as of FYE 2019. The results might raise concerns over a "Value Trap" situation, potentially affecting the Group's earnings given the softening of the property sector's outlook.

IJM Inventories Analysis		FYE 2019
Land Held for Property Development		631,921
Raw Materials		
Construction Materials		10,829
Other Raw Materials		132,266
Finished Goods:		
Completed buildings		995,584
Quarry and Manufactured Products		170,127
Palm Kernels		2,058
Oil Palm Nurseries		8,710
Fertilisers and Chemicals		16,777
Store, Spares and Consumables		20,232
		<u>1,356,583</u>
Finished Goods:		
Completed Buildings		18,726
Crude Palm Oil		35,213
Consumables		1,135
Palm Kernel Expellers		287
Crude palm Kernel oil		4,865
		<u>60,226</u>
Property Development Costs		6,819,288
Total Inventories (Current)		8,236,097
Grand Total Inventories		8,868,018
Inventories Relates to Property Development		84.02%

Figure 13. IJM Inventories Analysis FYE 2019. Source: IJM Corporation Berhad, Annual Report (2019).

(2) Increasing Gearing Despite Lower Revenue: Finance Cost Pressure on Earnings Vulnerability

Gearing and Finance Cost to Debt ratios are rising despite lower revenue performance. While IJM's gearing position is considered "acceptable" by industrial norms, the rising borrowings anticipated with IJM's investment in mega concessions and joint venture property development projects will foresee an increase in the financing costs in the long run. The market uncertainties across IJM's business segments might expose the Group to a "credit crunch", adversely affecting the earnings and the ability to meet the repayment obligations. Figure 14 below shows a correlation between IJM's decline in share price and the rising Finance Cost to Debt ratio trend.

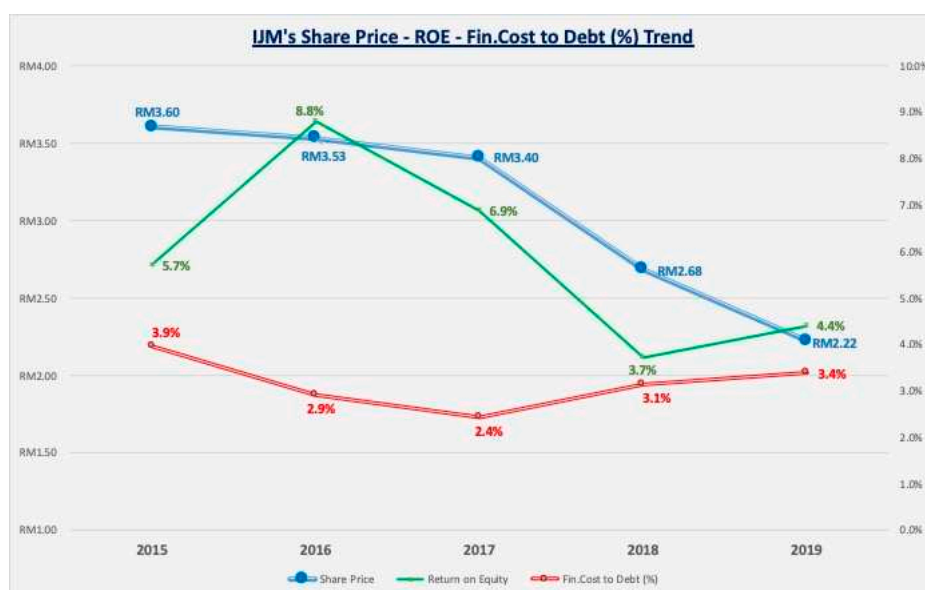


Figure 14. IJM Share Price, ROE, Finance Cost to Debt Trend 2015–2019. Source: IJM Corporation Berhad, Annual Report (2019).

(3) Diminishing Pre and Post-Tax Margin: Vulnerability Against Challenging Business Outlook

The Group's earnings have been under pressure since FYE 2017. FYE 2019's Pre and Post Tax Margin has reduced significantly compared to FYE2016 at 48.8% and 53.9%, respectively. The plantation segment has recorded its first losses over the last five years. Terminating the RM 1.13 Billion Light Rail Transit LRT 3 underground contract and the high property inventories due to the property over-hanged situation will adversely affect the Group's business outlook. Pressure from the government on the limitation to increase highway concessions revenue might affect the respective segment's growth outlook. The global economic recession impact of the COVID-19 virus pandemic may likely worsen the Group's business outlook, both domestically and abroad.

The following sensitivity model (Figure 15) illustrates the vulnerability of IJM's earnings in correlation with Finance Costs and Earnings Before Interest and Tax (EBIT) regarding its FY2019 financial performance. Based on the market dynamics and the unaudited quarterly results at the point of this case study, the trending of IJM performance is towards the lower-left quartile of the sensitivity model.

		Sensitivity of IJM's Earnings Before Interest and Tax (EBIT) and Finance Costs on PBT (RM' Billion)																				
		EARNING BEFORE INTEREST AND TAX (EBIT)																				
		-100%	-90%	-80%	-70%	-60%	-50%	-40%	-30%	-20%	-10%	0%	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
FINANCE COST	-100%	0.00	0.09	0.17	0.26	0.35	0.44	0.52	0.61	0.70	0.78	0.87	0.96	1.05	1.13	1.22	1.31	1.40	1.48	1.57	1.66	1.74
	-90.0%	(0.02)	0.06	0.15	0.24	0.33	0.41	0.50	0.59	0.68	0.76	0.85	0.94	1.02	1.11	1.20	1.29	1.37	1.46	1.55	1.63	1.72
	-80.0%	(0.05)	0.04	0.13	0.22	0.30	0.39	0.48	0.57	0.65	0.74	0.83	0.91	1.00	1.09	1.18	1.26	1.35	1.44	1.52	1.61	1.70
	-70.0%	(0.07)	0.02	0.11	0.19	0.28	0.37	0.46	0.54	0.63	0.72	0.80	0.89	0.98	1.07	1.15	1.24	1.33	1.42	1.50	1.59	1.68
	-60.0%	(0.09)	(0.00)	0.08	0.17	0.26	0.35	0.43	0.52	0.61	0.69	0.78	0.87	0.96	1.04	1.13	1.22	1.31	1.39	1.48	1.57	1.65
	-50.0%	(0.11)	(0.03)	0.06	0.15	0.24	0.32	0.41	0.50	0.59	0.67	0.76	0.85	0.93	1.02	1.11	1.20	1.28	1.37	1.46	1.54	1.63
	-40.0%	(0.14)	(0.05)	0.04	0.13	0.21	0.30	0.39	0.48	0.56	0.65	0.74	0.82	0.91	1.00	1.09	1.17	1.26	1.35	1.43	1.52	1.61
	-30.0%	(0.16)	(0.07)	0.02	0.10	0.19	0.28	0.37	0.45	0.54	0.63	0.71	0.80	0.89	0.98	1.06	1.15	1.24	1.33	1.41	1.50	1.59
	-20.0%	(0.18)	(0.09)	(0.01)	0.08	0.17	0.26	0.34	0.43	0.52	0.60	0.69	0.78	0.87	0.95	1.04	1.13	1.22	1.30	1.39	1.48	1.56
	-10.0%	(0.20)	(0.12)	(0.03)	0.06	0.15	0.23	0.32	0.41	0.50	0.58	0.67	0.76	0.84	0.93	1.02	1.11	1.19	1.28	1.37	1.45	1.54
	0.0%	(0.23)	(0.14)	(0.05)	0.04	0.12	0.21	0.30	0.39	0.47	0.56	0.65	0.73	0.82	0.91	1.00	1.08	1.17	1.26	1.34	1.43	1.52
	10.0%	(0.25)	(0.16)	(0.07)	0.01	0.10	0.19	0.28	0.36	0.45	0.54	0.62	0.71	0.80	0.89	0.97	1.06	1.15	1.23	1.32	1.41	1.50
	20.0%	(0.27)	(0.18)	(0.10)	(0.01)	0.08	0.17	0.25	0.34	0.43	0.51	0.60	0.69	0.78	0.86	0.95	1.04	1.13	1.21	1.30	1.39	1.47
	30.0%	(0.29)	(0.21)	(0.12)	(0.03)	0.06	0.14	0.23	0.32	0.41	0.49	0.58	0.67	0.75	0.84	0.93	1.02	1.10	1.19	1.28	1.36	1.45
	40.0%	(0.32)	(0.23)	(0.14)	(0.05)	0.03	0.12	0.21	0.30	0.38	0.47	0.56	0.64	0.73	0.82	0.91	0.99	1.08	1.17	1.25	1.34	1.43
	50.0%	(0.34)	(0.25)	(0.16)	(0.08)	0.01	0.10	0.19	0.27	0.36	0.45	0.53	0.62	0.71	0.80	0.88	0.97	1.06	1.14	1.23	1.32	1.41
	60.0%	(0.36)	(0.27)	(0.19)	(0.10)	(0.01)	0.08	0.16	0.25	0.34	0.42	0.51	0.60	0.69	0.77	0.86	0.95	1.04	1.12	1.21	1.30	1.38
	70.0%	(0.38)	(0.30)	(0.21)	(0.12)	(0.03)	0.05	0.14	0.23	0.32	0.40	0.49	0.58	0.66	0.75	0.84	0.93	1.01	1.10	1.19	1.27	1.36
	80.0%	(0.41)	(0.32)	(0.23)	(0.14)	(0.06)	0.03	0.12	0.21	0.29	0.38	0.47	0.55	0.64	0.73	0.82	0.90	0.99	1.08	1.16	1.25	1.34
	90.0%	(0.43)	(0.34)	(0.25)	(0.17)	(0.08)	0.01	0.10	0.18	0.27	0.36	0.44	0.53	0.62	0.71	0.79	0.88	0.97	1.05	1.14	1.23	1.32
	100.0%	(0.45)	(0.36)	(0.28)	(0.19)	(0.10)	(0.01)	0.07	0.16	0.25	0.33	0.42	0.51	0.60	0.68	0.77	0.86	0.95	1.03	1.12	1.21	1.29

Figure 15. Sensitivity Analysis of IJM EBIT and Finance Costs on Profit Before Tax FYE 2019. Source: IJM Annual Report 2019, Author generated (2023).

Conclusions

Conglomerate Business Model: The Case of IJM Group

A conglomerate comprises multiple businesses operating in different markets and controlled by the same management. The standard type of conglomerate is a parent company with one or more subsidiaries, which can be partially or wholly-owned companies that operate different businesses, respectively. The business model of a conglomerate has its advantages and is commonly adopted as a means for growth and increase profitability at the same time to diversify the business risks from a particular market segment and industry (Kurtović, Siljković & Dašić, 2013). The conglomerate's rapid growth potential, primarily via mergers and acquisitions, which leads to the perception of high-growth multiples, also suggests companies with a conglomerate model are popular among investors (Smith & Schreiner, 1969; Dean, 1969).

While the advantages of a conglomerate model seem logical, the complexity of the conglomerate's risk management and decision-making also presents significant challenges. Over the last three decades, many conglomerates failed due to underestimating the management complexity and limited evidence that the business model provides better protection against economic downturns (Kim, 2007; Walters & Helman, 2020). The lack of exemplary leadership and diversity of experience to lead the strategic change could result in the company's lack of shared vision and direction. The need for both resources and efforts to understand the dynamics in the different business sectors, business operations, etc., shifts the management's focus from core business activity to other business areas, which can potentially lead to poor performance in all the sectors. While the idea of a conglomerate advocates the potential of expanding the resource bases, it also presents rival competition over these internal resources. This competition potentially leads to the non-maximization of value creation.

The early stage of IJM's corporate strategy towards a conglomerate's merger and acquisition growth model proved effective, which contributed to the achievement of commendable financial results and value creation, which elevated the Group as a "Premium Conglomerate" company in the Malaysia Stock Exchange. The success of IJM mainly contributed to the coherent merger and diversification strategy towards value chain integrations from core competencies in construction and engineering, which are synergistic with the property development, infrastructure and concession segment (Shulman, 2017). The non-coherent plantation division is a non-related diversification strategy to mitigate the risk and vulnerability to the significant market decline. Effective leadership

and management style were critical in IJM's early success (Brauer & Müller-Stewens, 2010). Under the stewardship of the former Group Chief Executive Officer, Tan Sri Dato' Tan Boon Seng@Krishnan, a trained professional accountant, and more than 30 years of experience with IJM, he managed to steer IJM into the successful merger with Road Builders Group. He was instrumental in the business directions for growth, financial performance and creation of the business segment structure maintained today.

Based on the analysis and findings, the increasingly challenging yet uncertain business environment and management's lack of sense of crisis seem to be the main reasons IJM's slow reactions to the business challenges. The absence of clear long-term business directions and accountability is suggested by the non-correlation of key management's remunerations to the company's performance in FY 2017 & 2018 (Figure 16). A strategic reform in IJM management leadership and reinforcement of a merit-accountability-based culture, which was once IJM's key success factor, is essential (Shulman, 2017). It remains resilient in the competitive and volatile business environment ahead. The IJM's conglomerate model is now put to the test for its robustness and sustainability, especially in the unprecedented global recession ahead.

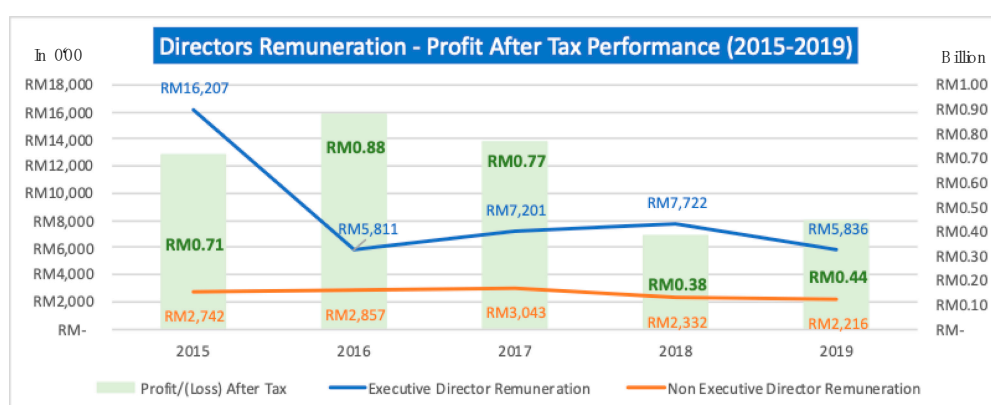


Figure 16. IJM Directors Remuneration–Profit After Tax Trend (2015–2019). Source: IJM Annual Report 2015–2019, Author generated (2020).

Potential Opportunities

The diminishing financial performance of IJM and the drastic change in the business environment conditions pose a highly challenging task for the management to maneuver its way through uncharted waters. As Albert Einstein said, "In the middle of difficulty lies opportunity". At the same time, the global COVID-19 pandemic economic crisis set unprecedented challenges to the worldwide economy. The ability of management to identify its organization's strengths and weaknesses and formulate corrective strategies timely to capitalize on the opportunities will enable the organization to learn from its experience and overcome obstacles. Regarding the analysis of IJM business segments and its market dynamics, as illustrated in Figure 17, the management may consider addressing the pressure over its earnings performance from a financial management perspective.



Figure 17. IJM Business Segment Outlook and Opportunities. Source: Author generated (2023).

Recommendations

(1) Correlation of Debt Management with the Current Asset Management

Based on the FYE2019 position, 49.1% (RM11.35 Billion) of the Group's assets are related to the Property Development Segment, which generates 23.6% and 31.2% of the Group's Revenue & PBT, respectively. Approximately RM7.45 Billion are in the form of inventories. Cashflow management is crucial, and poor financial control is one of the leading causes of corporate failure (Mutti and Hughes, 2002). The administration should consider an aggressive marketing plan to improve the inventory level, which will help to reduce the gearing level partially, hence decreasing the finance cost to enhance earnings. The management should also consider unlocking partial asset value by disposing of some strategic land banks or non-core development projects to improve profits and reduce gearing.

Factors to consider for the business model is the trade-off of potential future earnings, potential fire sales at a loss, and challenges to identifying potential buyers.

(2) Review Corporate Financing Strategy to address the rising finance cost pressure on earnings

In the context of project financing, it is essential to note the impact of uncertainty on cash flow which might potentially lead to the mismatching of debt maturity and asset maturity (Converse, 2018). The consequence of the mismatching maturity will have an adverse financial impact on IJM's credit rating and its future borrowing ability (Goswami, 2000). With the drastic changes in business outlook and uncertainties, coupled with the Group's concession investments which are long digestion periods, the urgency of IJM's management to review its cash flow and repayment capability is crucial to ensure no disruptions in repayment and credit rating. With the reduction of OPR by Bank Negara Malaysia, the options on debt refinancing or equity injection via rights issues to lower the debt exposure will potentially improve the Group's earnings and strengthen its cashflow position to remain resilient in the challenging business environment.

Factors to Consider: Soft Market Outlook might render fundraising exercise challenging, the risk of potential credit downgrading given the current market outlook, Challenges to identifying potential investors, and penalty cost of early redemption.

(3) Consider a Product Diversification or Exit Strategy for the Plantation Business Segment:

In FYE2019, the total land area of the Plantation amounted to approximately 73,061 hectares. 70% of the Malaysian Planted Areas are in the Mature Prime Stage. The IJM plantation segment's performance is high dependence on the market volatility of Crude Palm Oil (CPO). In 2018, the European Parliament (EP) voted to ban palm oil usage for biofuel production in the European Union (EU) by 2020, which is highly associated with the climate change movement, to prevent deforestation of rainforests, mainly in Indonesia and Malaysia. The ban's impact resulted in increased market uncertainty and the volatility of CPO prices (Figure 17).

Soft demand remained the main reason for the IJM plantation segment's poor performance. The losses from the plantation segment have affected the overall group results adversely. The continuity of market uncertainties will impose concerns over the cash flow health and the ability to meet its financial obligation. Therefore, the management should evaluate the strategic direction of the plantation segment.

The National Agro-Food Policy (NAFP), which is aligned with the Asian Integrated Food Security Framework and the Strategic Plan of Action on Food Security, identifies the agro-food sector as a competitive and sustainable industry which can increase the income of the agriculture sector. With an annual projected growth of approximately 4.6%, the agro-food sector is set to generate more than USD 10 billion annually of the Gross Domestic Product by 2020. A product diversification strategy is to venture into Argo-food-based crops, which are the least volatile and quick to harvest, to mitigate the exposure to the CPO market. Alternatively, consider an Exit strategy to better utilize the resources for other core segments.



Figure 18. Malaysia Crude Palm Oil Price Trend 2015–2020. Malaysia Crude Palm Oil Price Trend 2015–2020. Source: <https://tradingeconomics.com/> (2020).

Factors to Consider: Soft Market Outlook might challenge finding partners/buyers, the trade of future earnings in the event market improves, and lack of expertise to diversify crops or products.

(4) Potential Recapitalization exercise in spinning off recurring income assets

Infrastructures and concessions are substantial initial capital outlay with a recurring income over a specified period. IJM's successful track records in infrastructure concessions of highways and infrastructure projects, both domestic and abroad, are favourable assets with a consistent revenue income stream. In FYE2019, this segment contributed approximately 41% of the pre-tax earnings. Therefore, the management may consider disposing of a strategic stake to sovereign funds or a potential REITs program to improve the cash flow position and mitigate debt commitments.

Factors to consider are potential authorities' restrictions on ownership over concessions and weak market outlooks that challenge finding strategic investors.

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