

# How Dutch infrastructure companies are defying low profit margins

We investigate the paradox of the Netherlands' infrastructure sector, which has experienced persistently low profit margins in recent years, but also very few bankruptcies. How is this possible?



Margins for companies in the infrastructure sector have been low for the past decade

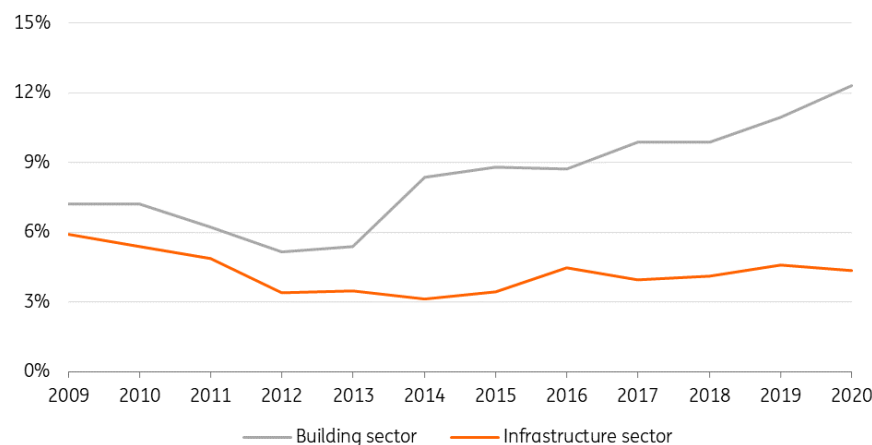
## Low profit margins

The profit margins of Dutch building (residential and non-residential) construction companies have increased significantly in recent years. Growing demand for new construction, the renovation of homes and commercial buildings, combined with more efficient construction processes ([through digitalisation and industrialisation](#)), have allowed companies to increase their margins.

In the infrastructure sector, on the other hand, which covers roads, railways, bridges, sewers, electrical grids, and so on, margins were already relatively low 10 years ago and have remained low.

## Profit margins for infrastructure companies have fallen in the last 10 years

Indicative Dutch profit margin (operating profit/total operating income)






Source: Dutch Central Statistical Office & ING Research

## Three main reasons for persistently low profit margins in infrastructure

1. Large infrastructure companies have incurred losses on large risky projects in recent years, where costs got out of hand. This has had an impact on the overall returns of the entire Dutch infrastructure sector.
2. The number of clients is limited in the infrastructure sector, primarily consisting of municipalities, water authorities and Rijkswaterstaat (Dutch Directorate-General for Public Works and Water Management). This limited pool of clients gives them buying power, which keeps profits low for construction companies in the infrastructure sector. Due to declining volumes, competition has further intensified, putting pressure on prices and margins.
3. Infrastructure companies generally have more machinery at their disposal compared to building (residential and non-residential) companies. This is evident from the higher average annual investments they make, particularly in machinery and transportation vehicles. This makes infrastructure companies more capital-intensive and increases fixed costs. As a result, variable costs are relatively lower than those of building companies. This brings additional risks when order books are poorly filled. Taking on projects below cost due to a lack of profitable contracts, just to cover a portion of the fixed costs, therefore happens more frequently in the infrastructure sector, which further erodes profit margins.

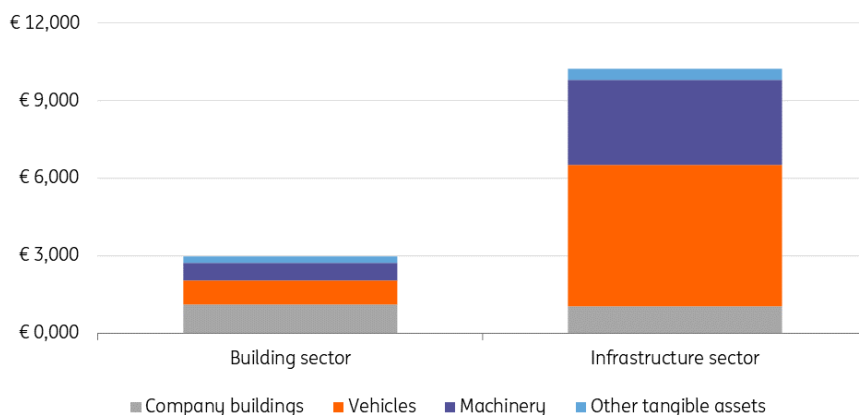
### Low profit margins in the infrastructure sector are due to:

-  Large high-risk projects
-  Clients with buying power
-  Taking on projects below costs

Source: ING Research

## High investment in the infrastructure sector

Average annual investment per person employed, The Netherlands, 2011-2020



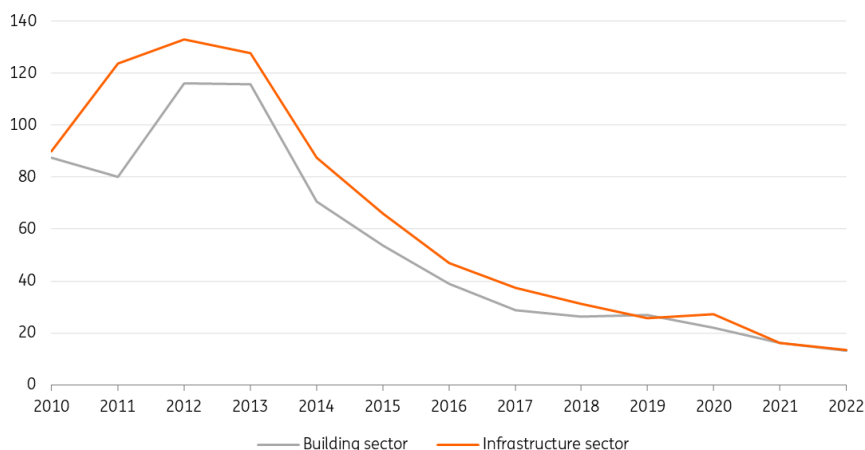
Source: Dutch Central Statistical Office & ING Research

## Relatively low number of bankruptcies

Remarkably, despite lower volumes, high investments and consistently low profits, bankruptcies have not increased. In 2022, fewer than 20 companies in the infrastructure sector went bankrupt per 10,000 companies, compared to more than 120 in 2012. This decline roughly aligns with the decrease in bankruptcies in other subsectors of the construction industry.

## Relative number of bankrupt infrastructure firms is about the same as in the building sector

Number of Dutch construction companies bankrupt per 10,000 companies per year



Source: Dutch Central Statistical Office & ING Research

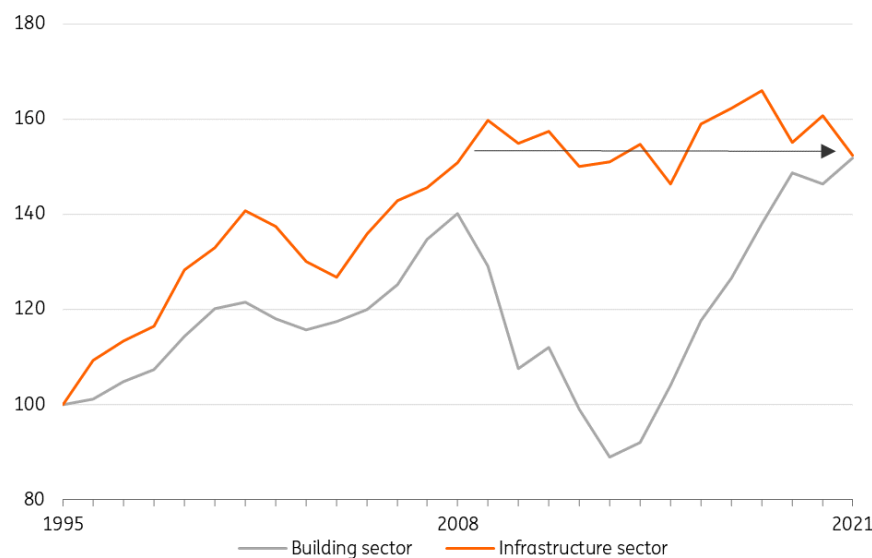
## Less volatile market and government contracts

We think there are three reasons why bankruptcies have not increased despite lower profits and declining volumes:

- The infrastructure sector is generally less volatile than other subsectors in construction. Governments often adopt countercyclical budget policies and tend to invest in infrastructure when the economy is experiencing a downturn. This results in fewer fluctuations in demand and limits the number of bankruptcies.

## Production volume less volatile in the infrastructure sector

Volume development subsectors construction (Index 1995=100)



Source: Dutch Central Statistical Office & ING Research

- Prices in the infrastructure sector are more frequently indexed compared to the building sector, allowing building material price changes to be passed on in such cases. Government agencies are often the clients, and they are not quick but more willing than, for example, those in residential construction, to negotiate price adjustments when costs exceed the budget. Although these negotiations are not always easy, they can help to prevent bankruptcies.
- The increase in new contract forms (e.g. two-phase approach) allows companies to better assess and distribute risks. Although these alternative contract forms still represent only a small portion of the market, they can help companies better protect themselves against financial risks. Most Economically Advantageous Tender (MEAT) bidding can also prevent competition from being solely based on price.

## What infrastructure companies should do



Select a clear business model



Invest in digital construction



Sustainable equipment

Source: ING Research

## What to do as an infrastructure company?

### Many opportunities due to necessary infrastructure investments

Despite the current market challenges faced by infrastructure firms, such as the [nitrogen issue](#), high prices and limited budgets, there are significant opportunities in the medium to long term. The coming years will see ample work due to the energy transition, climate adaptation and mitigation, and the digitalisation of society.

### Make a clear choice for the business model

Infrastructure companies need to make clear choices regarding their business model, deciding between a strategy of integrated design for two-phase contracts or positioning themselves as price competitors in the bidding market. Two-phase contracts carry fewer risks but require a different approach, especially in terms of planning and engineering (first phase) and require specialised knowledge.

Choosing to focus solely on the bidding market is also an option, particularly for smaller infrastructure companies. However, risks are higher in this case, and these companies must strive to become real "price competitors" in order to work at the lowest possible prices. Specialisation is necessary for this model. While it increases competitiveness, it also entails more risks if demand changes. Therefore, building a financial buffer to absorb (temporary) demand shocks is desirable. Diversified infrastructure companies with multiple areas of expertise face these risks to a lesser extent. However, the disadvantage of this latter strategy is that a company may not excel in any specific area, which can make it more difficult to secure contracts as specialised companies may submit better bids for each submarket.

### Sustainable business processes

It is essential for infrastructure companies to focus on sustainability in their construction processes. The sustainability of equipment will become increasingly important for many projects as it becomes a requirement for clients.

### Embrace digitalisation

Further [digitalisation](#) of internal processes is crucial for companies to work more efficiently and address labour shortages. It can help alleviate personnel shortages and make the company more competitive.

## Author

### Maurice van Sante

Senior Economist Construction & Team Lead Sectors

[maurice.van.sante@ing.com](mailto:maurice.van.sante@ing.com)

### Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an

investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.