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How new business ventures can boost real estate profits

In the dynamic landscape of the GCC region, real estate developers have long been shaping cities and economic growth. Although traditional optimization strategies related to procurement, financing, and construction play a crucial role in enhancing profitability, developers can also explore new business opportunities and revenue streams.

GCC real estate companies can build on their capabilities and skills, and their developments' captive demand, by expanding into "adjacencies"—businesses beyond their core competencies that can generate profits and hedge against market volatility. To expand successfully, developers should define their potential adjacencies, choose which ones to focus on, and determine how best to establish those businesses.

The first step for developers is to review the real estate value chain and identify new opportunities that are close to their core business. Facility management, for example, can often provide a quick win, and operating assets such as marinas and entertainment venues can further diversify revenue streams. In the longer term, developers can look further from their core to businesses such as hotels, restaurants, and retail outlets.

The second step for developers is to select which businesses to expand into based on projected earnings and an assessment of implementation feasibility. Service businesses, such as property and facility management, are usually the least capital intensive. Our research shows that businesses like these can generate internal rates of return (IRR) in the range of 30% to 40%, dependent on the developer's market and competitive environment.[1] However, developers should be careful not to venture too far from their core into businesses that require different expertise and capabilities.

Internationally, a notable success story is the Canary Wharf Group—the owner and developer of nearly 100 acres of property in East London that comprises office, residential, retail, and entertainment spaces. The group capitalized on its development's sizable captive demand by expanding into property and facility management.

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In the GCC region, Aldar Properties, a real estate developer in the UAE, has built a lucrative portfolio of adjacent businesses encompassing development and project management services, and property and facility management. It also operates hotels and shopping malls.

The third step for developers is to decide how best to set up new businesses. Options include self-develop, joint venture or licensing, or mergers and acquisitions.

For example, Majid Al Futtaim, a developer in the GCC region, has adopted a licensing approach to expansion. Originally a shopping mall developer and operator, the company moved to operating Carrefour supermarkets, under license, across the Middle East, Africa, and Asia. This strategy integrated retail with the company's real estate developments and capitalized on the demand of its residents.

Expansion into adjacent businesses can generate significant profits. For example, Aldar Properties and Majid Al Futtaim generate over 40% and 30% of their gross profits, respectively, from their non-core activities. In both cases this amounts to more than US$1.5 billion annually.

However, developers should exercise caution during expansion, as venturing into multiple businesses simultaneously can strain resources and create integration challenges. Instead, developers should execute with a disciplined and phased approach, focusing on getting the business right rather than executing quickly. Striking the right balance between investing in new ventures and funding core businesses is also essential. Last, developers need to be mindful not to venture too far away from their core business.

To conclude, expansion into adjacent businesses represents a lucrative and promising opportunity for real estate developers in the GCC. By gaining a detailed understanding of the market landscape, and executing a controlled, phased approach to growth, developers can propel their businesses forward and reap significant rewards.

[1] We analyzed the financial statements of over 10 local, regional, and international companies, operating in relevant service businesses such as facility and property management.

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