Evolving Market—Same Risks (Back to **Table of Contents**)

In good markets and bad construction enterprises fail. The explanation is complicated because it is the result of continuing industry changes some occurring simultaneously. Which of these changes or combination of changes is more or less to blame is not always clear. In addition, how to react to each enjoys little agreement among practitioners. A recent example demonstrates the complexity.

An underperforming general contractor was told that what he needed to do to reverse his decline was to get bigger or get smaller because the marketplace he served had changed dramatically over time. Unfortunately he could not be convinced. Over several years a number of his competitors had grown substantially or had merged with larger firms and at the same time quite a few of his steady customers had been bought by national firms and began to give their construction and maintenance work to larger, regional or national contractors. The market he dealt in was changing and work available to his size organization was shrinking.

With the contractor's limited resources, getting much bigger was unlikely and he was insistent that he did not put his entire life into building his company to get smaller now. His refusal to react cost him his business. Many are facing similar circumstances. The construction industry is undergoing such dramatic changes that some predict that many of today's midsize companies will merged, be acquired or otherwise cease to exist over the next 10 to 15 years.

Contractors are receptive to information about performance improvements and profitability enhancement, but almost universally resistant to research defining consolidation within the industry. It looks like most will not react until it is a certainty. The unwelcome news in irrefutable--construction is rapidly becoming standardized, technology is simplifying the process and growth in project size are just a few of the significant changes happening all at once.

To explain the impact on an industry of technology change a simple example is appropriate. Not that long ago contractors built wooden forms from scratch to custom designs for complex concrete projects. The competition was limited to contractors with people who knew how to do this work. But since then the process has been revolutionized by patented form systems that require much less skill to install—almost to the degree that anyone can do it. Standardization modifies an industry and encourages new entrants.

Economies of scale help lower costs using standardized processes. Unfortunately, most small and midsize construction companies lack the resources to reduce costs and schedules as fast as customers now demand. Larger enterprises are able to change and start-ups have no old habits to overcome.

Historically construction was a "can-do" industry of brawn and might, with a tradition of building projects with basic equipment and limited technical support. A lot of projects were built with a backhoe and a box full of tools. It has been said that all you need to be a contractor is pickup truck, a cast-iron stomach, a forgiving wife and a bad temper. The truth is that historically success demanded a rare combination of talents, including the abilities to muster resources to build a project; putting an accurate price on the work in advance; managing labor, subcontractors, vendors and designers through a long and arduous process; and tolerating a high degree of risk.

Contractors of this breed had great success as long as their methods of bidding--and our costs for individual items of work--were closely guarded secrets, and as long as our production of complex projects remained a mystery. But all of that has changed. New technologies and wide access to information have demystified the processes of estimating, organizing and producing the work. And even facilities owners and designers have become quite knowledgeable about such processes and the underlying costs.

Construction was a custom effort. Double-digit profit margins compensated for the inefficiencies. Now contractors are working harder and making less money. Despite an exceptionally good economy, construction margins have slipped into the mid and low single digits and even lower for larger contractors. Structurally altered margins will not return to historic highs. Consequently, as construction becomes increasingly standardized, efficiency and productivity will become the major differentiators among competitors.

Some pass up the chance to become more efficient complaining that they can't afford to upgrade their people and are too busy for training. Low margins restrict resources, making it harder for small and midsized businesses to invest in increased efficiencies. Larger companies suffer the same low margins, but their size enables them to invest in production improvements, to satisfy the shifting demands of owners. Continuous improvement has become a necessary cost of doing business and is becoming critical to survival.

Ironically some small contractors will fare better than some midsized firms, because there will always be a place for niche players. Specialty contractors will enjoy relatively higher margins until consolidation moves into full throttle. Small and midsized firms may be able to accomplish large-scale efficiencies through cooperation, but their window of opportunity will be brief. Profitable well-managed enterprises will survive by becoming part of larger organizations, or by serving niche markets.