VIEWPOINT

CONTRACTORS' CONSOLIDATION

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Prepare for a Huge Die-Off

In a recent turnaround effort in the Midwest, I tried to convince an underperforming general contractor that his market had changed dramatically. Several of his steady customers had been bought by national firms that were giving their "local" work to regional and national contractors, and several of his competitors had grown substantially or had merged with larger firms. What he needed to do was get bigger or smaller.

But with his limited resources, getting bigger was not going to happen. And as he told me, "I didn't put my entire life into growing this company to give up now." His refusal to react appropriately cost him his business. Others may face a similar fate. Tens of thousands of today's midsize construction companies will cease to exist within the next 20 to 25 years, if not sooner.

In my work, I counsel construction firms about making performance improvements and profitability enhancement. I see that it will be more difficult to advise them as consolidation unfolds, because most will not react until it is a certainty. As a past chairman of the Continuing Education Committee of the Associated General Contractors of America, I know the difficulties in educating contractors about the implications of consolidation. But the unwelcome news is unrefutable, and the cause, simple. Construction is rapidly becoming standardized.

When I was an apprentice, we learned to build wooden forms from scratch, and to custom design for complex projects. The competition was limited to contractors with people who knew how to do that. But since then, the process has been revolutionized by patented form systems that require much less skill to install.

Economies of scale help lower the costs of using standardized processes. Unfortunately, most small and midsize construction companies lack the resources to reduce costs and schedules as much as customers now demand.

COMMODITIES I remember my father's comment when a chain store opened in our town: "They'll never make it. A person needs to know his grocer." I hope that contractors' customers are more loyal. But when the products of other service businesses such as groceries, gas stations and farms became commodities, consolidation immediately followed.

In every case, consolidation of entire industries took less than 25 years. However, to date in the U.S., the amount of construction provided by large publicly traded corporations has been inconsequential compared to that put in place by more than 1 million separate and independent small-to-large contractors.

When I joined the industry at age 16, construction was a "can-do" industry of brawn and might, with a tradition of building projects with basic equipment and limited technical support. My brother and I built a lot of buildings with a backhoe and box full of tools. I've heard it said that all you need to be a contractor is a pickup truck, a cast-iron stomach, a forgiving wife and a bad temper. The truth is that, back then, 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 our 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.

When I went into business in 1961, construction was a custom effort. Double-digit-percent profit margins compensated for the inefficiencies. Now I constantly hear, "I'm working harder than ever and making less money." Despite our current, 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 those of the 1970s and '80s. Consequently, as construction becomes increasingly standardized, efficiency and productivity will become the major differentiators among competitors.

'TOO BUSY' Some will pass up the chance to become more efficient. Contractors often tell me, "I can't afford to upgrade my people. Besides, they 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. When I speak to trade associations, I regularly say, "Continuous improvement is a necessary cost of doing business." As a result of consolidation, it is now critical to survival.

Ironically, some small contractors will fare better than midsized firms, because there always will 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.

How many will disappear in coming years? From my study of other industries, I predict more than 100,000 mostly midsize contractors—20% of today's number of substantial construction enterprises. The profitable well-managed ones will survive only by becoming part of larger organizations, or by serving niche markets.

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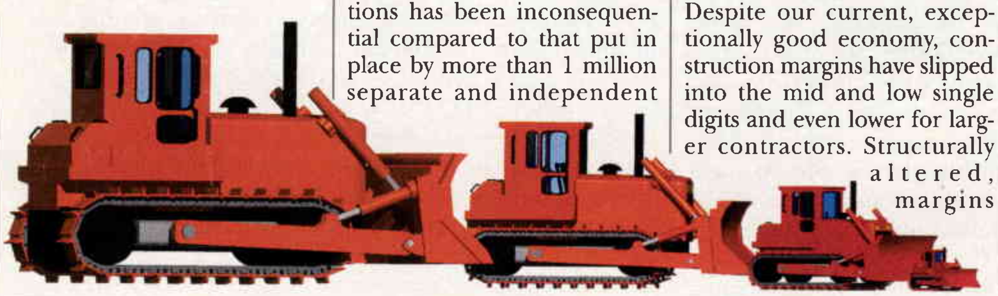

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