Industry Trends Affecting Contractor Operations

Volume Up, Profits Down? Here are Some Explanations

For the last several years, the U.S. construction industry has found itself in a unique situation. Even though there has been an expansion in the market, profit margins haven’t reacted accordingly. Construction remains one of the least profitable industries in our economy.

Some unusual situations are occurring which influence this lack of profitability.

Field Productivity Continues to Decline

Studies show today’s average construction worker is only productive for two hours and forty minutes out of each 8-hour day. From 1972 to 1979, the productivity index fell from a base of 100 to 82.9 and is still headed down.

Construction work remains more manual than other industries. The application of advanced technology in construction has been slow to take place. Research and development in technology are typically funded by large manufacturing corporations and aimed at manufacturing applications. Construction presents special problems and, so far, the funding hasn’t been made available to discover the unique solutions required.

Another reason for the decline in productivity is the rise of open shop operations. For years, unions had a stranglehold on management with work restrictions and upward pressure on wages and benefits. This pressure caused many companies to go “double-breasted.” But, open shop labor wasn’t as well trained as union labor. Individual companies became more responsible for the training effort—a role many of them were unaccustomed to, particularly in light of the fairly transient labor force. As a result, productivity suffered. Today, the number of untrained workers in construction is increasing. Many older, experienced workers are retiring and younger people replacing them—particularly in open shops—don’t have the necessary training.

The shift away from union labor is pressuring unions to devote more resources to training in response to market demands. The traditional adversarial relationship between management and labor is changing. Companies must cooperate with labor to keep workers and get jobs. Unions no longer see management as the enemy. The enemy today is the open-shop operation.

To keep people working, management and unions must cooperate. So, the effort to increase field productivity through education and training is crossing traditional boundaries. Unions are now interested in productivity improvement and meeting market demands. Open shop contractors are also seeing the need for better trained field people.

Another factor adversely affecting construction productivity is drug and alcohol abuse on the job. The pressures of construction create an environment where substance abuse can flourish. And, there can be no question that drug and alcohol abuse strongly decreases productivity.

Most companies can find specific areas where opportunities for productivity improvements exist. For example, immediate improvements can almost always be made in job planning and scheduling. Training field managers in supervisory skills is another opportunity for improvement. Both informal and formal corporate communications are now more important. Communication, motivation and productivity are closely related because companies are more fully accepting the responsibility to adequately train and motivate employees.

Many successful contractors now have formal productivity improvement programs in place. Companies ignoring productivity issues are losing ground.

A Strategic Response to High Risk

Construction risks are increasing dramatically. Today, people will “resort to the courts” for almost any real or imagined infraction. Claims are increasing. More cases are going to arbitration or even trial. Owners want it

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built faster and completed sooner to get early occupancy income. Contractors can fast-track to compete in a tight market, but fast-tracking increases risk with the owner as well as other contractors on the job.

These uncertainties emphasize the need for a company to carve a niche in the market that will endure over the long term. Contractors are learning to look at internal strengths and weaknesses to develop marketing flexibility by developing primary plans and contingency plans to correspond to changes in the economy and the market. This process has long been known in other industries as strategic planning. It helps avoid costly mistakes associated with impulsive actions. Because strategic planning involves an analysis of market conditions, the contractor can take corrective measures while maintaining a proactive mindset. This kind of risk management impresses bankers and bonders who hold the key to success for many contractors.

The geographical diversification of contractors in an attempt to maintain sales volumes adds to the risk of doing business. When a contractor relocates to a new area, special management problems arise. Many contractors use a formal strategic plan to determine where to go, and how to control things when they get there.

The Changing Face of Field Management

Contractors are going to have to pay more attention to education and on-the-job training for employees. Managers have to be trained in management theory and practices to meet the demands of a changing workforce. Contractor/owners themselves have to change old management habits. They are going to have to delegate responsibility and authority, release the reins and implement systematic management practices. Employees want to know what is expected of them and what they can expect in return.

The current scarcity of qualified field managers impacts contractors. Many experienced field managers are retiring, and they are being replaced by younger workers with more formal education, but less field experience. These new field managers are often thrust into positions of responsibility without a thorough understanding of the work itself. In addition to the obvious problems in this situation, more subtle difficulties arise from the natural antagonism between these young field managers and older, more experienced crew members.

Contractors are realizing the value of an engineering education for project managers as they see an increasing need for value engineering and design/build applications. Many project managers coming into construction are educated in the classroom rather than on-site. The scarcity of experienced field supervisors and project managers combine to make field operations more dependent on structured management systems and practices. This trend may be beneficial because consistent, practical management on the job site can significantly increase productivity.

Contractors are realizing the need for take-charge people to handle company divisions or expansions into new
geographical locations. These people are hard-driving, energetic and motivated by compensation or long-term compensation potential. But contractors adding such bold personalities to their management teams may face unexpected organizational changes.

A trend is developing to use teamwork principles both in mid-level management and in the field. Effective teamwork requires contractors to focus more attention on understanding individuals and learning new management practices.

Marketing in Construction—
A Timely Trend
Marketing is now becoming a hot topic in construction. For years, FMI tried to sell marketing programs to contractors. Finally, in 1982, our marketing seminar was a great success. We continue to see increasing interest and sophistication in using marketing in construction, even though some confusion remains about the difference in sales and marketing. There are several reasons why contractors are turning to a structured marketing approach.

First, the “good old boy” network isn’t what it used to be. One factor in its erosion is that a large share of non-local contractors are moving into local markets and taking work. National developers are doing an increasing amount of work and taking certain contractors with them, stripping work from local firms. Cost competition is also putting pressure on long-standing business relationships.

Customer service is also gaining importance in construction today. The construction product remains essentially the same, so it’s the degree of service and customer satisfaction that separates one contractor from another.

Construction firms are narrowing their focus and concentrating on the markets for which they are best suited. They determine where they are most profitable, have the most experience and where the demand is greatest. To make this determination, some companies are using market research—with either in-house employees or an outside marketing research firm. They are using more sophisticated marketing tools in direct mail, project presentations and public relations to dovetail with detailed marketing plans and implementation strategies.

The growing substance abuse problem is also fueling a greater need for marketing. Contractors are finding themselves in a “damned if you do and damned if you don’t” situation. They are being forced to institute new testing and safety procedures. Yet, they’re also faced with liability for accidents as well as the legality of the testing itself. Owners, concerned about quality and safety, are requesting information about procedures in place to control substance abuse on the job. Contractors are finding that they need to publicize or market any preventative procedures they’re using to combat substance abuse. Unfortunately, today’s realities make this effort necessary.

The more competitive the industry becomes as it matures and as foreign contractors do more business in the U.S., the more important marketing will become.

The Computer—An Increasingly Valuable Construction Tool
Management information systems (MIS) are probably changing faster than any other aspect of managing a construction operation. Computer technology is now supplying information about the construction operation itself, not simply financial data. Computer software is available for job cost packages, estimating support, purchase order control and other information needed by project managers and field supervisors. Field supervisors use personal computers to process time sheets, purchase orders, material deliveries and percent complete. Electronic networking allows information entered in the field to be sent to the central computer, processed, and returned to the field manager as a complete-to-date job cost report.

Another significant trend in construction is the growth of personal computers. Sound programming, documentation and vendor support
now make computer benefits available to almost everyone. As contractors grow geographically, the decentralization of management control means computers will probably process information at the local site. Computers in branch operations, computers in the field, computers in the home office are all necessary for information support. The decentralization is creating the need for more powerful personal computers as well as for connections to a central computer clearing house.

The application of technology in construction is just beginning. As technological advances make new, automated processes practical, the dependency on computer-driven information systems will increase. Robotics, electronically piloted equipment and trucks, sensing equipment for monitoring stress and other programmed production methods tied into the central computer system will weave a tighter web of automated information control.

These forces are combining to make the MIS function an integral part—rather than a supporting function—of construction operations. Career opportunities in this area will be increasing as information technology develops. Many contractors are already using the efficiency of scheduling and project management systems as a marketing tool to help sell prospective customers.

Equity Transfer—
Mergers and Acquisitions

Trends in the area of merger/acquisition are changing the structure of the industry and, eventually, those changes will affect all contractors. There is a tendency for divestiture of construction subsidiaries by large conglomerates. Large, publicly held companies are finding that the highly volatile construction industry can have negative effects on their annual earnings. Essentially, construction is a no-growth business and not very productive for publicly held firms. The industry may remain somewhat isolated from other industries which may force more interdependence among contractors to keep the industry strong. Some construction firms are recognizing these facts and spreading their risks by buying outside of construction but in construction-related businesses.

Tight underwriting restrictions by sureties today are accelerating the industry consolidation. Many firms find themselves with excellent opportunities but without adequate bonding capacity. Some firms solve this problem by merging or being acquired by another firm to get an infusion of capital.

There is a continuing trend in construction toward renovation or rehabilitation. Many large firms are either creating or acquiring divisions to perform these services. As a result, competition is increasing for small, local firms that have traditionally worked in this market.

Today, there are more construction firms in the U.S. than there is available work to support them. The economic law of supply and demand will even out this imbalance. With no forecast for construction activity to dramatically increase, the obvious balancing mechanism is to reduce construction capacity. That implies a continuing industry shake-out or consolidation.

More international contractors are
entering the U.S. construction industry. European and Australian companies have penetrated the cement and ready-mix segment, the building materials segment and the aggregate segment by purchasing U.S. firms. Foreign firms are interested in the U.S. market because:

- Their home economies are stagnant.
- The U.S. offers a stable political environment.
- The Middle East market has virtually collapsed.
- Competition throughout the world for large projects has increased.
- Foreign companies realize they can compete in the U.S.

Research and development spending for U.S. construction is only one tenth of one percent (.001) of sales. Japanese companies, for example, invest up to four percent. Without more R&D investment, contractors may find themselves in the same non-competitive position as the auto and steel industries.

U.S. contractors may have to band together in R&D efforts to meet this challenge from abroad—an unprecedented move in this fiercely proprietary and competitive construction industry.

In response to the Tax Reform Act of 1986, more companies are going to elect Subchapter S status. Subchapter S status impacts the amount of taxes owed by a company and the amount of capital accumulated in the company. Although Subchapter S status makes it simpler and more tax efficient to take money out of a company, sureties will resist this change because many construction companies are already undercapitalized. Continuity planning alternatives may change the way banks and sureties look at the capital structures of contractors.

There is increased sensitivity to business continuation issues because
- Bankers and sureties are focusing attention on the future to decrease their risk.
- Regulation, litigation and financial pressures have taken the “fun” out of construction for many owners who now want to get out of the business.
- Contractor/owners are reaching retirement age.
- Change of ownership is easier because the new tax law eliminates the capital gains tax differential.
- Family problems often cause attention to be focused on business continuity issues.

What Do These Trends Mean?

Based on current trends, the successful contractors in the future will develop effective management systems, increase productivity, market their work, plan strategically and involve employees in each process.

The construction market looks like it will only become more competitive. Any edge a company can develop—from sophisticated information management to outstanding customer service—will help make its future much brighter.