 By Thomas C. Schleifer

Pressure on Midsize Firms

In 2000, I wrote that the number of existing general contracting enterprises would be reduced by 20% by 2020. Recently, I started to update my research for the years 2003 to 2012. At first, it looked like I was wrong because, leading up to 2008, mergers and acquisitions slowed. However, the recession brought changes.

From 2008 to 2012, the entire construction industry shrank by 19.6%. During the slowdown, larger general contractors held on to more market share than smaller ones. ENR's top 100 contractors declined only 14.5%, and the top 300 dipped only 16.1%. This means the remaining businesses shared less of the market, getting disproportionately smaller while the largest businesses captured more market share.


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We can look to other industries that have consolidated for a better understanding of the issues. Shortly after World War II, most of the food consumed in the U.S. came through smaller, often mom-and-pop grocery stores; other than specialty markets, most of that now comes through huge chain stores. The same goes with privately owned gas stations, which have been replaced with franchises or stations that are directly owned by oil companies.

Historically, the construction industry had been an exception because the amount of construction provided by large and other publicly traded corporations has been minor compared to that put in place by more than a million separate and independent small to mid-size contractors. However, in the past three decades, that trend has reversed itself—a sign the industry is consolidating. The design portion of the industry already has consolidated a great deal.

In the past, success in the construction industry demanded a rare combination of talents, including the abilities to muster resources; put an accurate price on the work in advance; manage labor, subcontractors and vendors through a long and arduous process; and tolerate a high degree of risk. Contractors of this breed had great success as long as their methods of bidding—and costs for individual items of work—remained closely guarded secrets.

Demystified Processes

All that has changed. New technologies and wide access to information have demystified the processes of estimating, organizing and producing the work, resulting in construction services being perceived as a commodity. This development led to a belief that there was negligible difference among construction enterprises and fostered less concern over which contractor was selected.

Fifty years ago, construction was a custom effort with double-digit profit margins that compensated for inherent inefficiencies. Margins have slipped into the mid- to low single digits and even lower for larger contractors. Structurally altered margins are unlikely to return. Construction has become increasingly standardized, with efficiency and productivity the major differentiators among competitors. Economies of scale and standardized processes help lower costs and tighten schedules, which gives larger companies an advantage over small and midsize contractors.

Larger companies suffer the same low margins as do small firms, but their size enables them to invest in production improvements to satisfy the shifting demands of owners. Because continuous improvement is a necessary cost of doing business, consolidation will become critical to survival for some contractors. The exception is niche players, which tend to be small rather than midsize contractors. Specialty contractors enjoyed relatively higher margins until consolidation moved into full throttle. Small and midsize firms may attempt to match larger-scale efficiencies by working together, but their window of opportunity is small.

With the recovery's increased work, continuing low margins will place added pressure on midsize enterprises, rather than larger firms. This trend accelerates consolidation to the extent that the profitable, well-managed midsize organization may have its options to succeed limited to serving niche markets or becoming part of larger organizations. ■

Thomas C. Schleifer, Ph.D., is a management consultant, a research professor at Arizona State University's school of construction and the co-author of "Managing the Profitable Construction Business: The Contractor's Guide to Success and Survival Strategies" (Wiley). He can be reached at tschleifer@q.com.

If you have an idea for a column, please contact Viewpoint Editor Richard Korman at richard.korman@mhfi.com.