



Lighthouse

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Construction Company Gets Too Big For Its Britches

In This Issue

Growth is not desirable at any cost. Management systems that worked when the business was small can be outgrown. When the small systems no longer fit, it can be difficult to trace the problems caused by work-arounds, safety margins and quick fixes to root causes.

Updating the management systems does not necessarily require capital investment. Assigning stakes in the accountability for the success of the business to owners, managers, sales, administration and operations turned this construction company around in less than one year.



A large construction company was losing bids on new projects. Paradoxically, clients respected the firm's capability and appreciated the quality. The company had grown with acquisitions over the previous three years. Nine companies had been added to the corporation. The nine new businesses added four more states to the combined company's territory. Unfortunately, the company was losing bids that owner-management knew they should have won. A variety of key bids were lost in the proposal stage AFTER the owners had sold the job to the client. Clients said the price was too high. How could the bids be so off the mark? The management was considering new enterprise resource planning (ERP) software to solve the problem. The ERP system had a \$200,000 price tag. Before signing the purchase order, the owners brought in Chesapeake Bay Associates to find the problems and recommend a good way to fix them. Hint: The new ERP investment wasn't the answer.

Goal Analysis

Chesapeake Bay Associates reviewed the operations of the company. It was a multi-state, multi-location construction business, which had grown rapidly with acquisitions. The sales staff covered a national territory. Sales management was centralized at the home office, and construction operations and job cost accounting were localized to the job site. The estimating, purchasing, and

accounting processes were regionalized. The sales team was losing bids to competitors who routinely underbid our client. Sales, earnings and free cash flows were falling. The owners of this business had one mission critical goal: Win more bids and stop the decline as soon as possible.

Interviews with the staff uncovered a generally uneasy feeling. The merging of the acquired companies and the effect it was having on performance was a consistent theme. Acquiring company employees as well as the employees of the acquired companies feared the loss of their jobs. The incumbents felt threatened by the acquired company staff, and the acquired company staff felt they were vulnerable to cost cutting. Everyone we spoke to understood the mission critical goal well enough: "...to get bigger and to get more construction jobs..." Staff interviews revealed numerous ideas about how to accomplish this. Many were concerned that management was keeping secrets. Management was surprised. They weren't trying to hide anything!

Construction operations were doing a very good job. Quality continued to be very good and timeliness and costs usually came in according to plan. Procedures were well defined in accordance with industry standards. Field supervisors reviewed all work for thoroughness, which proactively maintained high quality of materials and workmanship. Procurement worked with their suppliers. The company maintained a very good reputation in the marketplace. Construction client appreciation was well-

documented.

The sales staff identified the best-fit projects with the potential for strong profit margins. However, the bid and proposal success rate had a low batting average. This was a dramatic turnaround from the company's earlier success. In many cases, owner-management had sold the project to the construction client only to lose the job to a competitor, who bid a much lower price. Everyone we spoke to offered an explanation for the extraordinarily high bids, but we found very little agreement among the various reasons when we compared our notes.

The owners could not make sense of the mixed signals, either. They had not analyzed the company's successes and failures. We continued to ask questions, looking for specifics. Accounting said they could only provide composite, or representative project cost data, which was more likely to be higher, not lower than the actuals. The procurement department added a markup on materials before passing material costs to the estimators. The estimators said they applied a "fudge factor," or markup, to each bid cost element. These multiplicative estimating factors evolved as a defense against job-insecurity. Estimators earned job performance credit for winning bids. There was no corresponding penalty for losing bids. Clearly, it was advantageous to bid high because you couldn't lose your job for making too many unprofitable bids. But, the company was losing business, which threatened the enterprise. The estimating process was out of control. Several projects were

New Processes For A Much Larger Company

lost to competitors who bid 17% lower than our client's estimated cost!

Strategy

The owners agreed that the turnaround strategy involved the job costing process and the integration of the acquired businesses. The bid and proposal process had to be aligned with actual job cost accounting and with procurement. Estimators and procurement would abandon the mark-ups and use actual labor factor and actual material cost inputs. Any mark-ups would be reserved for calculating the bid price at the end of the process. There was also agreement that accountability for losing bids was needed to align the credit for winning bids with corporate goals.

The owners agreed that the second element of the turnaround strategy was to implement a system of accountability. This was accomplished early in the company's history by word-of-mouth. The larger geographically diverse business would establish accountability beginning with publishing the company's goals, values, policy and strategy. Sharing this information up and down the chain of communication along with expectations for individual and group performance is the quickest route to action. Feedback from the organization on individual goals and plans aligns the operations of the business with the corporate strategy.

We have found that organizations that are afraid of making mistakes tend not to do very much. The value judgment is that inaction is less error-prone than doing something that could be wrong and costly. It is easy to agree that this judgment is wrong, unless you are the one who is afraid for his job! Knowing your job, having a say in how it gets done, and ac-

countability for your goals comprise the surest way to work.

Solutions

We worked with owners, managers and staff to implement 6 solutions.

1. Updated the ownership needs and wants in relationship to extreme the growth obtained from the acquisitions. Defined the monetary goals for the company as a whole and for each of the acquired companies. Defined the duties and responsibilities of the home office and field managers. Defined the goals for the managers of each of the national, regional and local offices with a prescribed level of sales and profitability.

2. Defined the tasks, duties and responsibilities of the estimators and purchasers for all of the regions. Replaced the estimating process with a common process used by all regional offices. Reassigned the responsibility for the calculation of cost contingency factors and proposed profit margins to the project managers working with the sales managers. Defined a price range for final negotiated prices expressed as bid price plus or minus a tolerance. Established a minimum acceptable level of job profitability as the pricing process control.

3. Identified the actual job cost and actual material cost information that was needed by estimators, project managers. Opened limited access to the existing enterprise system, which enabled estimators and project managers to work with the actual data.

4. Created an incentive plan for all non-officer and non-sales personnel in the company. Aligned the staff incentive plan with the officer and sales incentive plans. Linked rewards to the achievement of corporate sales and profit margin goals

and to the ratio of bids won to bids offered.

5. Sales, project managers and estimators joined a process of analyzing winning bids against actual results. Estimators were assigned the accountability for bids lost as well as bids won. Losing bids that varied by more than plus or minus 5% from the winner's price were broken down and analyzed. Bid elements were targeted that could increase customer value without compromising the company's sales and earnings targets.

6. The company resumed its former production levels within seven months. The pipeline of new contracts was increased to full capacity as well. The sales closure rate improved in every region. The company developed a reputation for high quality and low cost. The migration to a new ERP system was canceled, which cut \$200,000 from capital spending.

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