GROWTH OR NO GROWTH?

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This Quarter: Reducing the Mystery in Your Future

Dear Reader:

Through the *FMI Quarterly*, we invite you to tap into FMI's memory and speculation, using both to help you build your intentions and to reduce the mystery in your future.

In this issue you will find an op-ed with two opposing views on the age-old growth debate.

Our chief economist includes his recap for the current quarter and forecast for the coming quarter, making up our Market Information column. In addition, our economist provides a detailed look at the markets available for commercial contractors — suggesting where owner-alliances might be formed.

Our interview with retired Skanska CEO Claes Björk is the first in our series on construction icons. He reflects on his past experience of being in the spotlight and on the global stage of a very large corporation in two countries.

Plus, we have our annual performance of public companies in this issue, making this Quarterly a blockbuster issue. There's an article on the use and fit of employee stock ownership plans. Our article on geographic business expansion

encourages the use of a systematic plan to determine your company's chance of success in this endeavor.

Our leadership group makes a business case for developing leaders within your organization. We have also included a feature that showcases three very different answers to the popular question, "How's Business?"

In the area of project management, we highlight a notable design-build project that's had success with their partnering effort. We also include a guide on planning and controlling your projects.

In addition, we have an article on the use of HR audits, and an informative article on mold — a growing concern for the industry.

Plus, much, much more! We aim to bring you the best thinking from industry leaders and FMI in a compact, highly useful manner. And if our thoughts serve only to provoke strong thinking and resulting action on your part, then we've served our purpose.

We count on your ideas to help make the *FMI Quarterly* a construction industry institution. Feedback is the breakfast of champions and we continuously seek yours. Please e-mail our editorial staff with questions or comments at **quarterly_info@fminet.com**.

Sincerely,

Jerry Jackson
FMI Chairman
FMI Quarterly Publisher and Senior Editor

Opposing Viewpoints: To Grow or Not to Grow

In our current soft economy many companies are opting not to grow their business and instead focus on maintaining and sustaining. Yet other companies are taking advantage of the talented labor pool that's available and expanding into new geographic markets.

At FMI, we've seen numerous companies through the years push growth, with varying degrees of success. Pros and cons exist for each side of the argument and in this issue's opinion-editorial, two FMI consultants take opposite sides to this ongoing debate.

Lanny Harer, a director with FMI, takes the approach that growth as a goal is best avoided in his article entitled, "A Case Against Growth." Harer argues that companies should focus on their core competencies rather than focusing on growing the top line. Growth should be a result, he says, not an aim.

Senior consultant Clark Ellis argues the opposite side in "Growth is Vital." Clark argues that growth is a vital component of the American lifestyle as well as the construction industry. Clark cites reasons that are less obvious, but perhaps more important, than the oft-named financial reasons for growing a construction firm.

Admittedly, these two articles are one-dimensional, and both authors in reality take a more balanced approach, evaluating the particulars of the company contemplating growth. However, we hope this exercise and debate will help you to consider or reconsider some important points on the age-old question — to grow or not to grow? That is the question!

A Case Against Growth

By Lanny Harer

During the last 10 years the U.S. construction industry experienced an unprecedented rate of growth. The value of work put in place grew from $463.7 billion in 1992 to $846.2 billion in 2002 — an 18% annual rate of growth. This additional work was consumed primarily by existing construction companies. Unfortunately, many of these firms are soon going to be paying a price for their gluttonous behavior as the construction industry finally feels the effect of economic uncertainty, military conflict, and spending cuts in both the public and private sectors.

Rather than focusing on growing the top line, a better strategy for contractors is to focus on their core competencies. Less is more! The following represents the reasons against growth.

DON'T CONFUSE MASS (SIZE) WITH MUSCLE (STRENGTH).

Being bigger as a contracting firm is not necessarily better; in fact, bigness or mass often results in weakness and vulnerability. Too often contractors get bigger for the wrong reasons. Here are a few of the frequently heard justifications.

- We must grow to be a vital and energetic company.
- We must grow to provide opportunities to our people.
- We must grow to gain greater market visibility and recognition.
- We must grow to increase our lines of surety and bank credit.
- We must grow if we are going to be considered for larger projects.
- We must grow to improve our financial results.

I know several companies who grew for one of the above reasons, but in fact achieved just the opposite result. They became less vital and energetic, had more turnover, achieved the kind of visibility and recognition they didn't want, etc. One particular general contractor discovered that some of his long-term clients had started giving work to a competitor. When asked, the client said he was concerned he would not receive the same service and performance that he had in the past. In another case, a specialty contractor found that his firm's growth resulted in significant erosion of gross margin on company projects. A detailed analysis revealed that new, unproven project superintendents and managers were the cause.

Wouldn't you rather be in a position to decline opportunities to grow rather than to have to seek them?

GROWTH SHOULD BE A RESULT, NOT AN OBJECTIVE.

To paraphrase Tom Peters, author of *In Search of Excellence*, "Most (contractors) that become larger, do so because that was the objective. They set out to grow. Unfortunately, most don't answer the more important

question of why do we want to grow?" For growth to be the result, a company would have to create a demand for its services. It would mean they were so good and so sought after, that customers would be beating down their doors. They would have a clear competitive advantage, distinctive competence, or unique market position. Wouldn't you rather be in a position to decline opportunities to grow rather than having to seek them?

GROWTH GETS IN THE WAY OF IMPROVING THE BUSINESS.

This is a variation on the last point, but too many contractors limit their definition of growth to size. Growth also means to improve, mature, progress, advance, heighten, develop, and evolve. How about these as possible "growth" objectives?

- "Grow" the skills and competency of our people.
- "Grow" our ability to increase our margins on every project we perform, not just a few.
- "Grow" the strength of our balance sheet and cash position.
- "Grow" the relationships that we have with existing customers.
- "Grow" our image and reputation in the marketplace.
- "Grow" new and better marketing strategies to improve our competitive position.
- "Grow" our project resumé and experience to become more diversified.

If a contractor is focused on or infatuated with growing the size of the business, it will be at the expense of accomplishing the above objectives. Consider "growing" something else besides volume.

We at FMI have seen how quickly contractors can decide to increase staff and their assets to perform additional volume, yet how paralyzed they are when faced with decisions to reduce staff or sell assets when the economy sputters and markets decline.

THE BIGGER THEY ARE, THE HARDER THEY FALL.

It has been my experience that many of the contractors who significantly increase the size of their business, see their margin percentage decline and lose control of their work in the field. These two results are closely related because the companies become less selective in the work they pursue and the people they hire to manage that marginal work. They scrape the soggy bottom of the hiring barrel. We at FMI have seen how quickly contractors can decide to increase staff and their assets to perform additional volume, yet how paralyzed they are when faced with decisions to reduce staff or sell assets when the economy sputters and markets decline. In fact, we observed an interesting phenomenon after the last two recessions.

The most successful contractors we know tend to be highly specialized in some area, whether it is a type of work, a market sector, a customer base, or technical expertise.

Contractors that moved swiftly to downsize their business returned to their pre-recession level of sales once the recession ended. These contractors did so with significantly less overhead than they had prior to the recession. Having conserved their capital, they were in position to take advantage of the rebound.

GET BETTER BEFORE YOU GET BIG.

The trend towards increased specialization and "nichemanship" continues in the construction industry. The most successful contractors we know tend to be highly specialized in some area, whether it is a type of work, a market sector, a customer base, or technical expertise. Ask yourself these two questions: First, what is your firm's specific area of specialty or unique competence? Second, are you as good as you can be or need to be in that area, at the current level of volume? If the answer to the first question is "We can't really identify one area," and the answer to the second is "No," then forget about growing the size of your business.

Too many construction companies pursue growth objectives for ill-conceived reasons or with too narrow a definition of growth. The result is too often that these companies under-perform financially, are less competitive, and squander precious capital and human resources. In these circumstances, growth is not good, but bad for both the company and the industry. ■

Growth is Vital

By Clark Ellis

"Without continual growth and progress, such words as improvement, achievement, and success have no meaning." — Benjamin Franklin

Growth is vital. Biologically, economically, scientifically, financially, and politically, growth is vital. What if our nation had stopped growing in 1900? We would be only 76 million strong[1]. Or what if the country had stopped growing in 1950? Our population would be approximately 151 million[2]. Today, we are a thriving nation of more than 281 million Americans. But one important question remains: Is bigger better?

In the case of the United States, the answer is a resounding yes. In just 52 years, our population increased 86%, but our gross domestic product increased 460%. What this means is that GDP per capita between 1950 and 2002 grew from $11,170 to $33,595[3] — Americans are three times as wealthy today as they were in 1950.

Opportunity goes hand in hand with growth. A growing, thriving organization creates opportunities for itself and for its people that would not exist without growth.

What about growing a business? What about growing a construction company? There are many good reasons to grow a construction company and countless ways to do it. I will discuss some of the less obvious, but more compelling, reasons for growth and the core concepts that make successful growth happen.

GROWTH AND VITALITY ATTRACT AND RETAIN THE BEST TALENT

Smart, motivated people are the most important resource for a construction company. In an industry where the average general contracting firm net profit is approximately 3%, and an additional 1% in net profit increases net profit by 33%, having a couple more "A" players on your team makes the difference between just getting by and excelling.

The best players are attracted to firms that are growing in revenue, profit, capabilities, geography, etc. Growth creates opportunity for "A" players to develop along with your organization, create their own career path, and to play an important long-term role in your firm.

GROWTH CREATES CREATIVITY

Necessity is the mother of invention. The individuals in your firm will be most creative when they are challenged to respond to growth and change. These pressures, growth and change, on the business environment often cause existing processes to break down, thereby allowing new breakthroughs in process improvement to occur. Once these new processes are in place, the business can achieve productivity and efficiency increases in leaps and bounds instead of incrementally.

Put another way, it is very difficult to summon the discipline and motivation to improve your current business processes — even if they need to be fixed — if the business is not under external pressure. By growing your business, you consistently provide the impetus for continuous process improvement and thereby can stay one step ahead of obsolescence. Jack Welch said, *"Don't manage — lead change before you have to."*

GROWTH CREATES OPPORTUNITY

Opportunity goes hand in hand with growth. A growing, thriving organization creates opportunities for itself and for its people that would not exist without growth. Through growth, your company could purchase and implement a new information system that would integrate your estimating, scheduling, billing, and accounting systems. Or you may be able to afford a new piece of equipment that could improve your productivity and in turn, make your company more profitable.

Individuals can grow their knowledge, capabilities, and experience by

participating in new types of projects, developing new areas of expertise, and playing increasingly important roles in the firm as growth demands. The firm is then able to enhance its influence in the market, raise its profile, and take on larger projects. The net impact is a virtuous cycle triggered by growth in knowledge and capabilities, which leads to new and larger projects. These new projects enhance the image of the firm, which in turn, leads to more opportunities for the company and its employees to build their knowledge, capabilities, and experience.

Finally, a growing firm provides opportunities for your "A players" to participate in the ongoing success of your organization. This participation could take the form of equity participation, profit sharing, or simply playing a valued role in the organization that motivates them to remain a part of your firm for the long-term. Some of your toughest competitors may come from ex-employees who, failing to see enough opportunity with your firm, leave to either work for a competitor or to start their own business.

GROW ACCORDING TO PLAN

While growth can be the driver of all the positive factors mentioned above, growth must be planned in order for it to be successful. The vast majority of contractors that go bankrupt or suffer major losses while growing have neglected to plan their growth. The legendary UCLA basketball coach John Wooden said, *"Failing to plan is planning to fail."*

If your firm is serious about reaping the benefits of growth, you must make growth a part of all your planning processes: strategic planning, marketing, and business planning. You must determine how you are going to grow, how much you will grow, how fast you will grow, where you will grow, etc. Growth without answers to those questions provides at best a random walk toward success and most likely sows the seeds of failure. Here are some specific strategies for growth.

GROW WITH WHOM YOU KNOW

The quickest and usually the least risky way to grow is by providing more of the services that you already provide to the customers whom you already have. If you are currently bidding work with these customers, target growing the amount of negotiated work that you do with them. If you are currently negotiating work with these customers, try to increase the amount of sole-source negotiated work that you do with them. Propose some innovative project delivery systems such as project partnering, high performing project teams, or strategic alliances.

As you perform more work with your best customers and as you create increasingly collaborative delivery methods, your knowledge and understanding of that specific customer's strategy, cost structure, and market presence will grow exponentially. At

If your firm is serious about reaping the benefits of growth, you must make growth a part of all your planning processes: strategic planning, marketing, and business planning.

the same time, your knowledge, understanding, and reputation in that customer's markets is greatly enhanced, creating opportunities for you to dominate a market niche. Dominating a market niche is one of the best ways for a contractor to create and capture exceptional value. Grow with your customers as they expand their businesses and geographic coverage. All of these methods, delivered successfully, will not only grow your company's revenue but its profitability as well.

GROW WITH WHAT YOU KNOW

Next up on the risk scale for growth is growing by doing more of what you already do — but doing it with new customers or in new geographies. For example, a mechanical contractor who has good capabilities and relationships with owners in the industrial market could leverage that knowledge and experience to expand its industrial business to an adjacent geography.

At its very core, a construction company is a knowledge entity. The value of its business has virtually nothing to do with the "hard assets" such as equipment and property.

CREATE A GROWTH CULTURE

If you want to create long-term profitable growth, you must create a growth culture. Culture is the collection of organizational values and behaviors — largely unspoken and undocumented — that determine the way that your firm does business. To effect a growth culture, you must plan for growth, set goals for growing the business, encourage growth, celebrate and reward successful growth. Management must demonstrate that the desired growth is important through their actions.

It is also important to measure the progress you've made toward your goal of growth. For example, you could track the percentage of your business that comes from existing customers and services as well as the percentage that is gained from new customers or services. Then, report this information at company meetings.

Create incentives that are tied to specific activities that you believe will drive profitable growth. For example, you could provide a bonus for all project managers who complete training for basic financial management — knowing that there is a positive correlation between financially savvy project managers and profitable growth. Whatever the incentives are, if applied effectively, they will create a culture that looks for, takes advantage of, and delivers value through growth.

GROWTH THROUGH KNOWLEDGE AND CAPABILITIES RATHER THAN PRODUCTS AND SERVICES

At its very core, a construction company is a knowledge entity. The value of its business has virtually nothing to do with the "hard assets" such as equipment and property. There is no factory or machinery to sell off in the event of a downturn, there are no retail channels to be leveraged.

A successful contractor's value is in the knowledge and capabilities of its

people and in the relationships that those people create and maintain with key customers, suppliers, and influencers. Instead of "we build office buildings," try "we are expert in our scheduling capabilities, knowledge of equipment sourcing processes, and our estimating/pricing capabilities." Now the firm is not limited to office buildings in its market approach. This type of market differentiation will ensure that your firm does not become a commodity.

At the same time, thinking in terms of knowledge and capabilities helps the contractor to determine what they are lacking that would enable them to successfully enter a particular new market. This enables contractors to avoid "growing out of business." By critically assessing the knowledge and capabilities you possess and comparing them to the knowledge and capabilities demanded by a new market or customer, you can quickly determine whether a) there is already a fit, b) there is a small gap that can be addressed effectively, or c) there is a large gap that will require time and investment to close.

Growth is vital. By growing profitably, you can create an environment where the best will thrive, your processes will continuously improve, and opportunities abound. At the same time, long-term, effective growth must be planned and managed as well as led and motivated. Create your growth culture by making growth an integral part of your planning processes, communication, and reward programs. ■

[1] *"Population and Housing Unit Counts: United States Summary," 1990 United States Census, Table 4: Population 1790 to 1990.*

[2] *"Population and Housing Unit Counts: United States Summary," 1990 United States Census, Table 4: Population 1790 to 1990.*

[3] *"National Income and Product Accounts Tables," Bureau of Economic Analysis, U.S. Department of Commerce, February 28, 2003, 1996 Constant Dollars.*

Departments

STRATEGY
When Strategy Doesn't Work

When the best-laid plans don't work, what's wrong?

Often, the planning team gets nailed for coming up with bone-headed strategy that never had a chance. Sometimes, that's true ... but it's rare.

More often, the reasons why strategy doesn't work can be found in implementation issues that were unintended or unforeseen.

NIH

This is the classic "your plan, not mine." NIH translates as "not invented here." Often, the NIH syndrome occurs in remote branches or business units. NIH can also occur in business units headquartered just down the hall, if the protagonists of the strategic plan don't provide continual communication and support. Find ways to expand the number of direct participants in the planning process. Using ad hoc teams to develop and refine action plans is one way of expanding the ownership of the plan.

VAGUE TO INVISIBLE

All strategy is easily understandable and readily apparent to those who create it. The corollary is that all strategy tends to be obtuse and murky to those who are the last to learn about the company's new strategy. Without concrete examples of exact behaviors, illustrative projects, typical contracts, etc., strategy tends to be fuzzy and quickly fades to transparent. Come up with at least five ways to clearly demonstrate what each of your strategies mean.

OPTIMISM

The goals seem clear; the strategies are simple. Why don't our people "get it" and do the right thing every time? If they would, we would have no problem staying on schedule. The reality is that change is always more difficult than the act of conceptualizing that change. It takes longer than expected. Put some daylight into the schedule!

MANDATE

Just saying it doesn't make it so. It takes visible actions because jawboning isn't the same thing as walking the talk. Today, few organizations operate with such

rigid command-control structures that the organization will simply turn on communicated orders.

The reality is that change is always more difficult than the act of conceptualizing that change. It takes longer than expected.

GOLDEN GEESE

Our past success provides most of the obstacles to our future success. The organizational imprinting created by yesterday's achievements often result in the cry, "Don't kill the goose that lays the golden eggs." Yet, to really develop momentum in a new direction it may indeed be necessary to put a goose to rest — or even a gaggle. Making the execution visible (by publicly shutting down a market or a line of service or means of project delivery) is one way to change the inertial forces within the company. Taking excellent resources from dead-end situations and applying them to growth opportunities will hasten the demise of the old and speed the development of the new.

INVESTED CAPITAL

"We've simply got too much invested (in people, plant, location, finances) to walk away from this initiative." So what's the answer? Throw more good money after bad? Every line of our business needs both a look-back law (evaluating our investment performance to date) and a crystal ball law (forecasting future investment performance with fair conservatism). The aim is to periodically justify the continuation or expansion of that part of our business.

BAD MANAGEMENT

Projects don't run themselves. Even when there is a good set of plans and specifications, solid project management is needed to bring most projects in on time, within budget, and with satisfied owners. Strategic plans are like that, also. They need a solid project management effort because these plans aim to build the most important project of all: the business.

BAD LEADERSHIP

If company leadership uses a flavor-of-the-month approach rather than consistent reinforcement of direction, strategy may not work. If company leadership uses mandates, rather than individual alignment, at least with key thought leaders, strategy may falter. If leadership expects every member to internalize the plan and be self-motivating, strategy will limp rather than stride. Great leadership signals consistent direction, continuously works toward alignment of thinking, and uses excellent tools to motivate people toward goal accomplishment.

INABILITY TO CONCEIVE TACTICS

Strategy is essential, but it doesn't provide short-term paths for success. Some companies consider their strategy to be so obvious that no detail of activities is needed. You may seek to win a war with a strategy of "air of superiority," but you'd

better have the tactical details that outline targets, weaponry, and contingent responses to potential enemy actions. In other words, good strategy still demands detailed action plans that outline who is going to do what and by when.

UNCLEAR RESPONSIBILITIES

If tactical action plans exist, traction may still not occur if individuals are not accountable for achieving specific outcomes within a discrete time frame. Your traction is generally proportional to your accountability. Put specific individuals into situations where their commitment is personal (Joe), not general (estimating). Then, provide continual performance feedback.

OPERATIONAL RATHER THAN STRATEGIC FOCUS

It may be called a strategic plan, but if the focus is on a "do-better" version of what we've always done, don't expect a strategic breakthrough in results. If your aim is somewhat improved performance, then a good operational plan may be all that's needed. If you're seeking a profound shift in results, then you'll have a better chance of achieving that with a truly strategic plan.

LACK OF EMPHASIS ON BECOMING DIFFERENT IN THE MARKETPLACE

If you are aiming for strategic change, that's hard to do without different aims in the marketplace. Shifting services, geographic domain, targeted customers, or means of project delivery all promise changes in how you are perceived in the marketplace. To become different in the marketplace demands different behaviors, not just greater efficiency. Without significant efforts in change management, strategic shifts are unlikely.

LACK OF PASSION FOR THE PLAN

"Boy, now that those planning meetings are over, I hope we can get some work done around here!" With this kind of thinking-out-loud, it won't take long for most everyone to opt out of pushing the plan. What's needed is commitment to the plan and a visible concern for the best possible implementation at the highest levels in the organization. Success in achieving the aims of your strategy is simply too important to leave to chance or to approach with indifference. ■

Jerry Jackson *is an FMI chairman. He can be reached at 919.785.9222 or by e-mail at jjackson@fminet.com.*

MARKETING AND SALES

Say No and Make More Money

Do you ever say yes to a job, and then just as you are getting started a better one comes along? Often, the problem is not that you want to say yes, but that you don't have a clear reason to say no. Organizations and companies alike rarely pause to consider alternatives and are all too willing to say yes. The remedy is a clearly articulated, well-defined marketing plan that results in a coherent strategy for obtaining the type of work you want. A key component is the go/no-go checklist.

It is critical that the entire organization be involved in the development of

your marketing plan and the go/no-go checklist. Oftentimes, the development and execution of the marketing plan is delegated to the individual in charge of business development. Thus, the marketing plan becomes their plan. A well-developed marketing plan represents the best thinking of the entire leadership team of an organization.

DEVELOPING YOUR CHECKLIST

Before you can develop a go/no-go checklist, you need to consider the work that you want to do and the work that you currently do. As you develop your go/no-go checklist think about your strengths and weaknesses. Then review a completed jobs analysis, your ideal project criteria, and your ideal customer criteria.

A key point here is that the parameters of a good project and a bad project can be well defined. They can be written down and clearly understood by the entire organization. Most companies have a general feel for what makes for a good project and a bad project. However, this general subjectivity allows too many shades of gray to encroach on a decision that should be somewhat black and white. This leads to the situation mentioned at the beginning of this article when you say yes to a project, when you should have said no.

APPLYING THE CHECKLIST

There are common elements that might be on any go/no-go checklist. The following example illustrates this point. The actual criteria you use may include these as well as others.

In developing your checklist, consider the relative importance of each of these criteria. For example, project size may not be as important as the owner. You can apply some type of weighted scale, or each criterion may have equal weight. Finally, you will end up with a minimum score in order for a project to be considered. In our example, the minimum score is 70 points.

Consider the following opportunity — a $5 million, 100,000 square feet of flex space 50 miles from your headquarters. The schedule duration is 16 months. It's tilt-up, and low manpower is required from your firm. But the owner wants an on-site superintendent and project manager. There is no bond required. It's negotiated with a GMP, with a good owner but a designer you don't know.

Our example company's go/no-go checklist is shown in Exhibit 1. The company's ideal criteria are listed on the left, and the current opportunity's specs are listed on the right. Then, as you consider each criterion you can compare it to your ideal and apply a score to the project opportunity.

Out of a possible 100 points, this job scores 71 points. So, for our example company this job looks worthwhile and should be pursued.

This exercise may also be done as a group, with the scores being averaged. There is some subjectivity in applying the scores, but quantifying

A well-developed marketing plan represents the best thinking of the entire leadership team of an organization.

Exhibit 1
Checklist for Project Evaluation

	Ideal Project	Current Project	Ideal Points	Actual Points
Size of project in dollars	4–6mm	5mm	10	9
Size of project	75–100 ksf	100 ksf	10	10
Location of project	0–25 miles	50 mile	10	4
Duration of project	8–12 months	16 months	10	4
Type of construction	Simple	Simple	10	10
Manpower requirements	Intensive	Low	5	3
Supervision requirements	Low	High	5	2
Bonding requirements	High	Low	5	2
Type of procurement	Negotiated	Negotiated	10	10
Type of contract	Cost plus	GMP	10	5
The owner	Known	Known	10	10
The designer	Known	Unknown	5	2
			100	**71**

your opinions in a well-thought-out manner will begin to give you a clearer picture of the opportunity.

When you apply this methodology to job selection, it becomes much easier to say no to a project.

Additionally, this checklist will present your company with a clear picture of the types of jobs that management views as a good fit. This can then be used as a communication vehicle for the organization. Too often, people in the field don't understand why the big job down the street wasn't bid. All they might know is that they are coming to the end of their current project, and if you are not bidding, then they may be out of a job in a few weeks. When the entire organization understands the thought process behind your company's project acquisition strategy, the strategy will be supported.

Keep in mind that this checklist is not meant to be a hard-and-fast rule for determining whether your company should take on a new project. For example, the company mentioned above may decide to accept a project that scored a 60 or 65 even though their minimum score is 70. Implementing a go/no-go checklist at your company, however, will serve as a good support system for the projects that you do decide to undertake.

Your marketing plan is the blueprint for your get-work effort. A well-thought-out go/no-go checklist is an integral part of your plan. The go/no-go checklist is the result of experience and historical data and will assist you in objectively analyzing projects in a consistent manner. Once you have a good checklist, the next time someone calls and they don't fit your criteria, you will be able to say no. And you will be glad you did when the right customer calls. ■

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The Quarterly Interview

Industry Icon:

Claes Björk

*This interview is the first of a series with icons of the construction industry. In this interview, **Claes Björk**, former CEO of Skanska AB, traces the arc of his career. Along the way, Björk **offers ideas and advice to leaders and managers of growing firms.***

FMI Quarterly: Claes, you've been on the global stage and in the spotlight of a very large corporation and you've done that in two countries. It's been a remarkable run and we thank you for sharing some of that experience with our readers. What three words or phrases would you use to describe your career to date?

Claes Björk: Challenging, rewarding, and very inspiring.

FMI Quarterly: Would you say if you look back at what you have accomplished that you had those as keen objectives all along . . . to do those things . . . or did the objectives sort of evolve out just a few years ahead as you moved through time?

Claes Björk: A combination, really. I never set out to become CEO of a large company or corporation. It was more meeting one challenge at a time.

FMI Quarterly: Climbing the ladder one rung at a time?

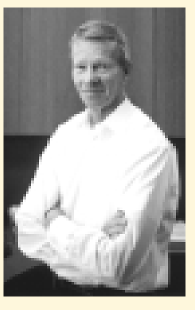
Claes Björk: I never felt that I was climbing a corporate ladder in the sense of making a career. It was more a matter of meeting the challenge of each project and making the best of it. As I succeeded, the promotions followed.

The real big kick was to help park all the equipment in the yard on Saturday afternoon so they all lined up nicely. You know, like all good contractors do.

FMI Quarterly: Let me take you back in time. Sort of a rundown of your life starting very early, like where were you born?

Claes Björk: In a small town in the western part of Sweden, Trollhattan, where they make the Saab automobile, just at the end of the Second World War,

FMI Quarterly: What are some of your stronger impressions about growing up in that small town?



PROFESSIONAL PROFILE

Claes Björk joined Skanska AB in 1968 after engineering studies in Sweden. From 1968 through 1972 he served in a number of field engineering and project management positions on civil construction projects in Sweden.

In early 1972, Claes was selected to serve as a vice president of the newly formed Skanska (U.S.A.), Inc. Through mid-1985, when he was elected President of Skanska USA, Claes participated in the construction of a number of significant infrastructure projects throughout the Northeast.

From 1985 to 1997, Claes held the dual position of President of Skanska (U.S.A.), Inc. and Senior Vice President of Skanska AB. During this period he spearheaded the rapid expansion of Skanska USA.

From 1997 to 2002, Claes was elected President and CEO of Skanska AB the global construction and project development giant.

Claes Björk: What I remember the most were good family values and work ethics. My younger brother and I spent a lot of time with our father hunting, shooting with rifles at the rifle range, and helping him in his business, which was construction — repair and rentals mostly. The real big kick was to help park all the equipment in the yard on Saturday afternoon so they all lined up nicely. You know, like all good contractors do.

FMI Quarterly: Were you an athlete?

Claes Björk: I played ice hockey in the winter, and I was on the kayaking team in the summer.

FMI Quarterly: Did you take either sport into college?

Claes Björk: No. To be competitive in kayaking you have to train too many hours. I really enjoyed the team spirit that came with playing ice hockey. In this small town, there were 80 peewee teams. My first experience with leadership was as captain of the peewee team.

FMI Quarterly: After high school, where did you go to school? Did you go to civil engineering school?

Claes Björk: I started with my bachelor's degree in Trollhattan. During that time my father needed my help in the family business. He had a small construction business, primarily equipment rental and repairs. I stopped school and helped him. That was during crucial years as far as my education was concerned, but I always felt that it was the right thing to do.

FMI Quarterly: So were you able to go back and finish your engineering at some point?

Claes Björk: Not immediately since I had to do my military service for 15 months. During that time Skanska contacted me. I had dealt with them while I was working with my father. I was 21 years of age when they offered me a job. Coming back to your question, I continued my engineering studies at evening classes while working for Skanska.

FMI Quarterly: Do you have children?

Claes Björk: Yes. I have two adult daughters from a previous marriage.

FMI Quarterly: Would you want them to have a career in construction?

Claes Björk: Yes. It's been very good for me; it's a very exciting profession. No two days are alike, and both of the girls are entrepreneurial. I think they would do very well.

FMI Quarterly: Did you make a conscious decision to pursue a career in construction or did it sort of unfold, first form your father's business and then Skanska?

Claes Björk: I have always been interested in the strategy, teamwork, and organization needed to accomplish construction projects.

FMI Quarterly: Going back to the very beginning with Skanska, what were your first jobs? Roles? Positions?

Claes Björk: When I was first hired by the civil engineering division of Skanska in Gothenburg, Torsten Hjertonsson was my mentor for many years. This was in 1967. At the time, there was a building boom in Sweden. The Social Democrats were building themselves out of a recession. In Sweden, like in the rest of Europe, there was a big need for residential units. As an example, Sweden built 104,000 units in 1968. When I returned to Sweden in 1997, they built only 10,000 units.

FMI Quarterly: The late 1960s period of housing expansion in Sweden, was that also driven by the Baby Boom?

Claes Björk: Yes. The same need for housing existed in a number of countries, all over the world.

FMI Quarterly: Why did Skanska hire you?

Claes Björk: Torsten Hjertonsson, head of the civil department, liked my practical and hands-on experience from the family business. He believed in me and gave me the chance to become a superintendent at the age of 22.

FMI Quarterly: What was your first project?

Claes Björk: It was a tunnel system for bringing all energy needs, such as electric, telephone cables, water, sewer, etc., into a future development before the actual housing construction.

FMI Quarterly: OK. So that was your first project. Did that project make money?

Claes Björk: Yes, it was challenging but profitable, which helped in my own advance to general superintendent.

FMI Quarterly: You've described Torsten Hjertonsson as your mentor. What was it about him, other than his interest in you, that makes you think of him as your mentor?

Claes Björk: He always took time to discuss what I was doing; he always listened to my reasons, and he would give his opinion. I could always call him at any time. He was very well respected among people in the company and also in the industry.

FMI Quarterly: Is he still living?

Claes Björk: No. Unfortunately he died much too young.

FMI Quarterly: So, he got to see part of your significant success in the U.S. but not the later part?

Claes Björk: Correct.

FMI Quarterly: What are some of the things that were lessons that he taught you?

Claes Björk: He was very similar to my parents; he also taught me how to find enjoyment and satisfaction in my work. The challenge in solving the daily problems always made the job self-fulfilling.

He also taught me how to analyze complex matters in a simple fashion, which helped me to communicate what needed to be accomplished and how it could be done. This ability served me well throughout my entire career both with my own teams and with my clients.

FMI Quarterly: You said he took lots of time with you and was always available to you. Did you carry that on to some people in your own dealings?

Claes Björk: I certainly did. Anybody who has worked for me has always had the opportunity to call me at any time of the day.

FMI Quarterly: What were the circumstances that led to your first visit to the U.S.?

Claes Björk: After that first project that I did for Torsten Hjertonsson's division, we were the low bidder on a water-intake project for a nuclear power station. It involved underwater blasting and excavation far out into the North Sea. He gave me the opportunity to become a project manager at the age of 24 — probably one of the youngest project managers at Skanska.

Form the beginning it was a rather hopeless job because we had tendered it very

aggressively using a method that turned out not to be feasible. My job was to find a better method. I remember that I used two old bridge girders to make a four-legged platform, which we could move up and down hydraulically. To move it on the water, we put two barges underneath and then we put two drill rigs with 70' masts on the deck. In effect, it looked like a small oilrig, but we did it very inexpensively. Of course, it was difficult to move and to get it in an exact position. With this rig, though, we managed to drill out and do that excavation in an extremely profitable fashion. So, I was lucky in finding the right method and with that, turning a difficult project into a profitable one.

FMI Quarterly: That sounds like a very good solution from a desperate financial standpoint. Was this an adoption of something you had seen or heard of elsewhere or was this sort of, "Why don't we try this?"

Claes Björk: No, it had not been done before. Actually, the idea came out of a discussion between Torsten and me.

FMI Quarterly: So, was it on the strength of that job then that led you to the U.S.?

Claes Björk: Yes, by then I had established a reputation for good leadership and resourcefulness. I had also spent five months in the estimating department. It was during that time that a joint venture with MacLean Grove and Grove International was established for the construction of a New York subway line. When we were the low bidder, I was asked to go to New York and "look after Skanska's interest." It was not a very well-defined position. I was to spend two years in New York City.

All in all there were more challenges to be a superintendent in New York compared to what I was used to from Sweden.

FMI Quarterly: And, you never actually went back until you went back to be CEO of Skanska AB?

Claes Björk: That's right. The first project turned out to take longer than expected. Between strikes and environmental groups trying to stop the job, my assignment took four years instead of one. Thereafter we were the low bidder also on the next section, and I was asked to stay.

FMI Quarterly: Were your strongest first impressions of New York what you expected them to be?

Claes Björk: The city was what I expected it to be. The complexity in getting

things done was much more challenging. The manning requirements by the unions, the constant negotiations between the superintendents, the management, and the various locals took a lot of time and were not very productive. The permitting processes were also very complex and time consuming. Building norms and restrictions were very stringent. So, all in all there were more challenges to be a superintendent in New York compared to what I was used to in Sweden.

FMI Quarterly: That four-year period of your first U.S. project was when?

Claes Björk: 1971–1975.

FMI Quarterly: At that point, you were still a 20-something with a pretty responsible role on behalf of Skanska in a foreign country. With the perspective that you have now, what advice would you give youngsters who are just taking on their first leadership or management role in a construction company? What would you tell them that they should focus on?

Claes Björk: It really depends on the position that they have and what type of work it is. Going back to my own experience on these types of complex, urban, and heavy civil projects, what I would advise them is to always plan the job to the very last detail.

The next thing would be to establish a team spirit between all parties involved, the contractors, the subcontractors, the owners, and the owner's representatives. You should have everybody on the same track and working together. For instance, too often you see engineers trying to be lawyers, arguing about contract conditions, etc. What I really think needs to be done is for our industry to refine the delivery methods for our services. The existing ones are not always in everyone's best interests or productive.

FMI Quarterly: On the flip side of that, what are some of the most repeated mistakes you see young managers making? Not repeated by them, but repeated among young managers?

Claes Björk: I think they don't always think through the consequences of their decisions. Again, they don't plan enough how to do the work before they start.

FMI Quarterly: What about older managers, after they have sort of earned their spurs, what mistakes do you see older managers make?

What I really think needs to be done is for our industry to refine the delivery methods for our services.

Claes Björk: Older managers are prone to make fewer mistakes because of their experience, but it is difficult to generalize. Some are more prone to rely on their trusted foremen and perhaps not get involved enough themselves in the long-term planning of the job and how to execute it.

FMI Quarterly: Would an older manager come up with a floating platform with four hydraulic legs?

Claes Björk: I don't think that has anything to do with age. The ingenuity has to be there. The danger, of course, for an older guy is to just rely upon what he's always done and be comfortable with that, without thinking in new terms.

FMI Quarterly: We've talked a little bit about profitable projects. Again, reflecting on the early half of your career, the most profitable projects with which you were associated, can you share anything about how and why they were profitable projects?

Claes Björk: The profitable projects as well as the worst ones have been the ones with the highest risks, such as the underground work in New York. In lump-sum, unit-price contracts with too many unknown factors, it is important to have fair contract conditions in order to avoid these roller coasters.

The most profitable project was the 63rd Street subway, which was an extension of the first job we had in Manhattan. We actually lost a great deal of money on our first project. So it took a bit of guts for Skanska management to allow us to go ahead and bid for the next section. Let me say that the loss that we had on the first portion we did recover eight years later in court.

The profit on the second section was so high that it exceeded our cost. What happened there was a number of things — we had the oil crisis in 1974 and when we were bidding for the job we thought that inflation was going to spiral out of control. We made a big allowance for inflation. There were only two bidders, so the risk allowances were very high.

I suppose one can say that both of my first projects in the U.S.A. were failures in a sense, the first one for the contractor and the second one for the owner.

FMI Quarterly: These weren't indexed contracts. You bid the contingencies?

Claes Björk: These were lump-sum jobs, and we put in our own contingencies. Again, obviously if the owner had had an indexed price schedule, we wouldn't have had to do that. The owner would have saved money.

FMI Quarterly: Did the windfall sort of capitalize Skanska's subsequent ventures in the U.S.? Was that the start?

Claes Björk: In effect, yes. Even though another of my mentors, Birger Löwhagen, believed in me. I am pretty sure that Skanska top management would have pulled

back if we had done two loss-making projects in a row. Birger, by the way, has continued to be my mentor throughout my career.

FMI Quarterly: Did Skanska at that time own Koch? (Then, Karl Koch Erecting Company.)

Claes Björk: No. We purchased Koch in 1982. Prior to that we worked in joint ventures together with MacLean Grove on underground works in Boston, New York, and Washington. At the same time, we were working overseas with Grove International. Phil Grove owned Grove International and that was the company that Skanska first interfaced with, building airports in Ethiopia in the 1960s. It was from that relationship that we got together with MacLean Grove for the first subway project in New York.

Phil Grove owned three companies: Grove International; Grove, Shepard, Wilson, and Kruge, which was a commercial builder. They were building the Albany mall then. He also owned MacLean Grove together with two gentlemen, Norman Nadel and Guy Simoni, who ran the company.

Skanska has joint ventures with MacLean Grove in New York and with Grove International in Oman and Saudi Arabia. Phil Grove died in a car accident in 1975. After that we took not an ownership role, but a bigger role within the Grove organization for financial reasons, as we were already involved in quite a few of their projects. Grove International was renamed Grove Overseas and we continued to work together with them. In 1977 we moved our offices together from Madison Avenue to Tyson's Corner in Vienna, Virginia.

During the 1970s, Norman Nadel and Guy Simoni took full control of MacLean Grove. We continued to work in joint venture with them.

FMI Quarterly: They were alliances?

Claes Björk: Yes.

FMI Quarterly: From there to the acquisition of Koch. How did that happen?

Claes Björk: There were a number of successful projects with MacLean Grove. However, it was the only real operative activity that Skanska had in the United States at the time, but we had gained a great deal of experience in U.S. construction practices. One thing I learned was that to do just tunnel work was just too cyclical and risky. It left too much to chance. You had to be both good and lucky to earn money over time.

During the 1970s, a great deal of subways, sewer systems, and water systems were built in this country. Those were good years for the heavy construction industry. The opportunities waned over time in the 1980s. What we realized was that we

The difference between what we did and what many other large European companies did when they entered the U.S. was that we took a long time to learn.

needed to diversify and the obvious thing for us, having been in New York all this time, was the bridge repair program that was forthcoming and an acquisition of Karl Koch was a great way of getting into that. Here was a company with an excellent reputation as a steel erector. With all the 2,100 bridges in New York — most of them made out of steel — Koch was in an excellent position to do that. That was what led to the acquisition in 1982.

FMI Quarterly: And that then started a series of acquisitions, most of which were certainly successful. Were any of the acquisitions a mistake as you reflect back on them? Characteristics of mistakes that were made in acquisitions? You don't have to talk about specifically who they were, but were there any major "if only" situations?

Claes Björk: Karl Koch was not our first attempt to acquire a U.S. company. Actually, it was Slattery. We worked in joint venture with Slattery, which was already in Washington in 1977. We came close to making a deal in 1980. I saw Slattery as a big potential for the company. They were more diversified because MacLean Grove and the work we did together with them in joint venture was very special — tunneling underground. Koch was also somewhat specialized in bridge building and repairs, a sector with much more potential. We saw Slattery all along as an even more diversified infrastructure builder, particularly good at urban civil construction.

In the end it was not until 1988 that we managed to acquire Slattery. I always strived to assemble a diversified group. We now had Koch in the bridge repair program doing very well and Slattery in the Northeast, diversified within the heavy civil sector. They both had very good connections with the subcontractors and owners and an excellent reputation. And, most importantly they had good leadership and dedicated employees.

FMI Quarterly: Most people would estimate growth through acquisition as being no better than a 50/50 proposition of success. Your U.S. and European success rate was much higher than 50/50. Why?

Claes Björk: The difference between what we did and what many other large European companies did when they entered the U.S. was that we took a long time to learn. We learned what the market was like and concentrated on companies with good management in a growth area, where they had potential to grow with us. What we contributed was a solid financial backing as well as administrative and technical support when it was needed. There were also a lot of things that we, within the large group of Skanska, could transfer between our operating companies. The growth that we have experienced has to a very large extent been organic

growth from the companies that we acquired. Together with us they all managed to take that extra step that was needed to grow profitably. The approach varied depending on the company and their particular situation. With Koch it was that they could work more as a prime contractor. With Sordoni and many of the other commercial builders it was the financial strength that we provided. Well, in all honesty, we hardly ever used the parent company balance sheet. I believe the "JFK Air Train" project that they are now finishing was the first project with a parent company guarantee. During this time I always insisted that our bonding line be based on the balance sheet of Skanska USA only. Another example of what we brought was the ability for our companies to take on more design/build projects. We also tried to have a good incentive program in place as well as possibilities for advancements. I think those were the things that made a difference. We also took our time with our acquisitions. FMI did a great deal of that work, as you know. We worked with Steve Darnell. I think Steve and I looked at more than 100 companies, so it was not just a matter of an investment banker calling up somebody in a boardroom in Europe and saying, "Hey, you've got to go after this guy."

I concentrated on good markets and good management because good management can produce even in slower times.

FMI Quarterly: How would you grade your tenure as head of Skanska's U.S. operation? What kind of grade would you give yourself?

Claes Björk: I leave that for others to judge. It went well though, but keep in mind that it took a long time to build up what Skanska has today in the U.S.

FMI Quarterly: How would you grade your tenure as CEO of Skanska AB?

Claes Björk: Others should do that. Personally I am very satisfied that we exceeded all of the goals of creating value for the shareholders that we set when I started as CEO.

FMI Quarterly: Talk some more about Skanska USA.

Claes Björk: With Skanska USA, the diversification was important as I mentioned earlier. I never was too worried about timing everything correctly from an absolute economic cycle point-of-view. I concentrated on good markets and good management because good management can produce even in slower times. It has always been difficult in the building and construction sector to really analyze and pinpoint the swings of the economic cycle and make acquisitions accordingly. Often in downturns we have had great emphasis on infrastructure, for instance. Another example is residential construction today. Here we are three years into an economic downturn and the residential construction market has never been as strong. I've tried not to rely solely on the macroeconomists.

I have always looked for good people, good management with — I like to use the

words stretch potential — people that want to work with us, that want to grow with us. They also need to be in a growing market or a market where they can take a larger market share.

With Koch and Slattery, I felt that we were quite diversified within the heavy civil side. We could have been better diversified geographically, which I later did something about. As you know, we acquired Tidewater later on, which gave Skanska good coverage all along the East Coast and an entrée in the Southwest.

The goal was to become even more diversified within the building business and that's why we looked at acquiring a commercial builder, a construction management firm. We looked at a number of those and again came up with an acquisition of a small company, Sordoni Construction Company. This was in 1989 and that was probably the worst time because the building boom of office buildings in particular was over. Actually, at that time you remember every fifth building was empty — about a 20% vacancy rate. The rationale behind the acquisition was almost entirely one of trust in the two guys that ran the company — Stu Graham and Mike Healey. As you know that has paid off real well for Skanska.

FMI Quarterly: The tax reform act of 1986 really impacted a lot of the commercial market.

Claes Björk: It affected that particular sector for 10 years. You could say that the acquisition was badly timed from a macro point of view. But Stu Graham and Mike Healey wanted to make a major push into the pharmaceutical construction business in which they saw great potential in New Jersey where they were headquartered. So, we structured a deal, and made the acquisition in 1989. They were very successful in the pharmaceutical construction business and that carried them over until the office and retail building started again.

By now, this was the beginning of the 1990s. We had a pretty good diversification of construction activities, both on the commercial building side and on the heavy civil side. But, we were still limited geographically.

It's interesting that we have had our best success in cities that are considered by outsiders to be the tougher cities to work in in the U.S., like New York, Boston, and Washington. But, that's because Slattery and Koch had been here for many years. They knew the subs, the unions, and the owners.

FMI Quarterly: And the reputation of those cities creates a sort of natural barrier to entry for some others.

Claes Björk: Larger national contractors used to stay away from small and medium sized projects but there was always a lot of competition.

In order to expand further geographically, we acquired Beers in 1994. I had been in talks with Larry Gellerstedt for a couple of years before we could make a deal. I felt that we needed to have a strong presence in the growing markets of the Southeast. It's difficult for a firm from New York to get in there and be successful.

FMI Quarterly: Start-up has been difficult for firms from anywhere in Atlanta, if you were not born to the table there.

Claes Björk: Community presence and awareness is important everywhere. It's a matter of trust. We always lived up to our commitment and the management of the sellers normally stayed on. We have had very few that actually left the company.

We also made a venture into residential development in the Northeast. In 1995 we predicted a big upswing in residential housing. At least from a local perspective, I saw it in Connecticut where I lived. We had an opportunity to acquire a small firm, run by a very good developer, Mitch Hochberg. The firm was small when we acquired it, but they have done well with limited financial opportunities. Once we started to back them, they did extremely well.

FMI Quarterly: With that success, or in spite of that success, you wound up going to Stockholm to take Melker Schorling's place as CEO. What are some of the highlights of your tour of duty as CEO of AB?

Claes Björk: When I was first asked, I think in March 1997, if I wanted to take over as CEO of Skanska AB in Sweden, I said, "No."

Melker and I had just agreed on a new five-year contract for me in the United States, and I was very happy with the situation. I saw a lot of growth potential here — we were in a good position. My wife had never lived in Sweden and after 25 years here, I felt more like an American than a Swede. So my advice to Melker Schorling and Percy Barnevik (Skanska's chairman at the time) was to try to find somebody over there. Melker was very insistent and in the end I did agree to take the job because I became increasingly concerned about a potential total dismantling of Skanska led by a new shareholder with a large block of voting shares. Since I had spent much of my career building Skanska USA, I thought that I could be of some help to Melker and prevent this from happening in an uncontrolled fashion for the construction and real estate activities.

The perception within Skanska was that this investment firm was using media to convey ideas as to what could be done with Skanska. This created a great deal of unrest internally. My deal with Melker was to take the CEO position for a couple of years. During this time Melker would find a successor and I could then go back to the United States and continue on my merry way. (laughter)

FMI Quarterly: And this was 1997?

Claes Björk: Yes.

FMI Quarterly: And as soon as you got there, Skanska had a major public relations issue with the Halland Ridge Rail Tunnel?

Claes Björk: Yes.

FMI Quarterly: Talk about that a little bit as it impacted you personally and what it called for from you.

Claes Björk: I realized when I took the position as CEO that there was a big difference in managing a private company compared to a large public company, particularly in a small country like Sweden, where you have five newspapers in the morning fighting for news. They are going to write about things you might not think are all that important and they are going to analyze what you say and do. This was something new to me. It was this lack of experience in handling the media that gave me some problems when we had the difficulties with the Halland Tunnel project.

FMI Quarterly: I don't mean to push this, but weren't there some dead cows downstream?

Claes Björk: This was a railroad tunnel that had been contracted for on a unit price basis with methods prescribed in the bid documents. After just a couple of weeks the site management told the client (the railroad authority) that they could not get the tunnel dry enough with just cement grout. The authority then asked them to find alternative solutions. Skanska came up with a method of lining the tunnel with concrete lining. Unfortunately, the railroad authority thought that was too expensive. A number of different grouting materials and techniques were proposed and one of them was this chemical grout. The tunnel became relatively dry or dry enough, but then it turned out that the overflow from the chemical grouting was running out through the tunnel. Cows drank the pump water as it was coming out of the tunnel and a number of cows, while they didn't die, fell down and had spasms and were subsequently killed. It took weeks before we really did find out exactly what had happened and what the damage was. In the meantime, hundreds of cows were slaughtered. We were of course particularly worried about our own people. Would they be affected by this?

It was with this as a background that I quickly realized that we really needed to handle crises differently. On this project it took a week or so before we really had our act together and slowly started to take control of the information flow. Another thing I learned was that we needed to increase our own knowledge of chemical agents even when the products are allowed.

What I also learned was that the loss of image can take a long time to repair.

FMI Quarterly: Do you have any advice for other executives who may confront a serious incident in public relations early in their career?

Claes Björk: Train yourself in handling all kinds of media and other public events. Make sure that you have a crisis management awareness program in place that works.

FMI Quarterly: In September 2000, Skanska withdrew from the Ilisu Dam project in Turkey.

Claes Björk: Yes.

FMI Quarterly: It was a multi-partner group including Balfour Beatty. The withdrawal was described on Skanska's behalf for environmental concerns. There were 25,000 people to be displaced and that sort of thing. Was that Claes Björk or was that Skanska? Skanska seemed to be moving toward, if not green, certainly an environmentally sensitive company.

Claes Björk: Well, it was certainly Claes Björk that started a rigorous environmental awareness program within the company immediately following the Halland Tunnel Project. We managed to have all our 150 units ISO 14001 certified. I believe we were the first company in our industry to accomplish this.

What I also learned was that the loss of image can take a long time to repair.

There are projects that are too controversial from an environmental perspective and too often the builder becomes the bad guy. Therefore, one has to say no sometimes; the prolonged aggravations are simply not worth it. Builders cannot be missionaries of the world all by themselves. In order to build projects that are environmentally sensitive, there first has to be a democratic process in place in the country where the project is going to be built and where the local people have a say. Once the country has determined that this is what they want to do, then everybody that is involved in the execution, starting with the lenders, has to be very clear as to what their environmental policies are.

FMI Quarterly: It is interesting that in doing what is arguably the right thing for environmental reasons and sociopolitical reasons of the country that is involved, some other ripples occur. One writer suggested that the withdrawal of Skanska from the project was an intentional effort to discredit Tony Blair, to embarrass Tony Blair because he was such an advocate of the project.

Claes Björk: No, of course not.

In the Ilisu project there were a number of contractual issues that could not be agreed upon by the joint venture partners. Since we could not come to terms with our partners, we decided not to continue.

FMI Quarterly: In the U.S. we think that we encounter political issues as you move from township to township or county to county, or sometimes state to state, or even between municipalities, but when you do cross-border work with multi-party participation in projects, things get significantly more complex. Earlier, you were talking about the need to plan. When you get into the global arena, to anticipate all the things that could arise — from local protests to accusations of intentional political embarrassment — it is an entirely different playing field.

Claes Björk: Yes.

FMI Quarterly: What do you see as the major challenges for global contractors and engineers in the next decade? What are some of the big issues going to be?

Claes Björk: The environment is a concern as it relates to awareness and respect. As leaders, you have to instill this into all employees and live by your preaching. Keep in mind though that environmental concerns also create good business opportunities.

Train yourself in handling all kinds of media and other public events. Make sure that you have a crisis management awareness program in place that works.

The perception of the industry leaves a lot to be desired. Unless we can do more to improve our image, we will not be able to attract the young and bright people that we need to succeed in the future.

Corruption is a big problem in many countries. The definition of corruption varies from one country to another. Here all industries need to have some global understandings. The difficulty is when you have a subsidiary company in a country where the corruption is widespread. Companies doing their business in such countries have to be very firm that there are no exceptions to the corporate code of conduct. There is just no other way around it. From time to time, you have to close businesses.

FMI Quarterly: From an industry image standpoint?

Claes Björk: The industry image will continue to improve as issues such as fair practices and environmental awareness are dealt with in all countries.

FMI Quarterly: In part, I think there is a greater understanding of the systems aspect of the big blue marble and the connectedness of an awful lot of those systems. They are not these little independent things such that you can kill a rain forest and there will be no effect from it.

Claes Björk: Today we are all more aware. But then again we can't just say that we have to get out of everything that could be a potential problem. We have to continue to build in order to improve people's lives around the world. It is the democratic process and the countries' economics that determine the level of their quality of life. Most everything we do as an industry should be to enhance the quality of life for people.

Most everything we do as an industry should be to enhance the quality of life for people.

FMI Quarterly: How about some reflections from your time as CEO of Skanska AB?

Claes Björk: Skanska has always been viewed as a builder, but the (public) market never really appreciated the pure construction side of Skanska. The value of the company used to be the market value of our non-core holdings, such as a stock portfolio of large Swedish companies like Sandvik Steel; SKF; Scancem, the cement manufacturer; and many more. When you add up the value of those holdings, it constituted the total market capital of Skanska.

My challenge in 1997 was to divest of all non-core holdings and still create value for the shareholders with the remaining construction and real estate business. Remember the non-core holdings were the entire value of the company. The industrial holdings were sold over a couple of years, with good results. It is interesting to note that the value of remaining business after the distribution was still approximately the same as before.

While we were disposing and transferring these assets to the shareholders, our goal was to increase the construction and project development.

Looking back at my career, I think that what we managed to do with Skanska AB was 100% in line with the strategy that the board and I agreed upon in December 1997. The entire market cap was returned to the shareholders by divesting the non-core holdings, and we still managed to maintain, even to increase, the total value of the company after the divestments.

Skanska revenues were 45 billion Swedish crowns (5.4 billion USD) in 1997 and in 2002 it was 140 billion Swedish crowns (16.8 billion USD). Most of that increase in revenue came

from the United States where the construction management business, in particular, increased their business during that time. In our strategic plan we also aimed to establish the company better throughout Europe. We acquired companies in England, Norway, Poland, and the Czech Republic.

Our preferred targets were the workout situations, like when we acquired Kvaerner in the U.K. They had a very good position in the U.K., and I really do think that over time they should have the same potential to grow in the U.K. as we have had in the U.S. They also have holdings in Hong Kong and India, which should be good footholds for growth over time even though it is slow right now. This was actually the last major acquisition I did. This was three years ago.

We needed to reorganize in such a way that we would maintain the entrepreneurial spirit and the very well-defined profit centers, but at the same time get more transparency and control from the parent.

In 2001, we organized Skanska into 18 business areas, most of them geographic, with one in Sweden, Norway, Denmark, etc. In the United States, we are organized into buildings and civil. We also had one business area for project development, real estate services, and telcom where we fortunately didn't make any major acquisitions.

The reorganization and control changes of the company took a lot of work. But we resolved it very well. And, after a difficult but profitable year in 2001, we saw continued earnings improvements in 2002, and I would think that this year should show even further improvements albeit in a slow market. This shows that we did the right thing by organizing and improving the cost controls, procedures, etc., the way we did it in 2000–2001.

FMI Quarterly: Why do you feel that public markets have difficulty with investments in construction companies?

Claes Björk: The difficulty with the valuation of construction companies from the stock market point of view has been the cyclicality and the perceived risks in lump-sum contracting. The ups and downs are correct from a quarter to quarter perspective but not over a longer period of time. By being diversified, both within different risk sectors of construction as well as geographically, one can mitigate the risks.

Most construction companies are struggling with low multiple valuations on their construction earnings. All publicly traded construction companies receive a great deal of their valuation from other activities that are closely associated with their building knowledge. In Skanska's case, it is the project and property development, and if you look at other companies, they all have different types of activities along side their building activities. Bouyges' valuation is to a large extent based on telcom.

Vinci is into toll roads, and several Spanish companies are into various types of services and toll roads.

FMI Quarterly: When you are doing development, usually there is a reduction in the return on capital employed (ROCE), as contrasted to that of construction only. Is that lower return offset by the reduced risk of that route as opposed to that of a pure builder?

Claes Björk: Over the last five years we had a ROCE in the development business of approximately 15% and that was with a low risk development portfolio. Approximately 85% was pre-leased before or during construction. Construction in the form of CM type of operations does not need to tie up much capital, so a 40%+ ROCE should be possible. For capital-intensive activities, such as heavy civil, asphalt, etc., the return is lower despite a higher margin due to their equipment fleet and increasingly larger and more liquid balance sheets to meet today's bonding requirements.

FMI Quarterly: Isn't part of the dilemma that it is very difficult to run a very large construction company as a private company?

Claes Björk: Not necessarily. You just have to make sure that your surety is satisfied with your balance sheet.

FMI Quarterly: It requires a capital market — who doesn't love them! (laughter)

Claes Björk: I believe that a combination of property development and construction, the way that we have done it at Skanska, works. The market is down right now but over time it will be valued accordingly.

FMI Quarterly: Good! How do you spend your free time when you aren't staying directly in touch with the industry now?

Claes Björk: I sail a great deal now. I bought a boat last year and that gives me a great deal of pleasure.

FMI Quarterly: Any parallels in skippering a sailboat and serving as a chief executive?

Claes Björk: There are times when I think it's easier to be a chief executive. (laughter) No, but here, too the crew has to plan ahead. They have to act early on weather forecasts; know their exact location, a safe route forward, and the danger zones. I think there are quite a few parallels between being a good sailor and being a good CEO.

FMI Quarterly: What is the last good business book you have read?

Claes Björk: Last weekend I read a great book about a topic that is on everybody's mind today, the divide between the USA and the rest of the world. The title is *Of Paradise and Power* by Robert Kagan. My current reading is an old book that I have not read since I was in school. It's Alexander Dumas' *The Three Musketeers.* The last business reading was the proceedings from the World Economics Forum in Davos.

FMI Quarterly: What are your plans for the future?

Claes Björk: My desire is to stay in tune with the industry. I think I can contribute with advice to companies; after all, I have had a unique experience in building up companies in the Unites States and in Europe, East Europe, the Far East, and South America. Perhaps I could be the kind of advisor that others in the industry might benefit from.

FMI Quarterly: Excellent! Thirty years from now, how would Claes Björk like to be remembered in U.S. construction?

Claes Björk: I think I want to be remembered as somebody that gave an opportunity to a number of great people that love the industry and did something good with it for the benefit of all.

FMI Quarterly: I think you will be. ■

Market Information: FMI's Construction Outlook

By Tim Aylor
FMI Construction Economist

The warm days of summer can't come soon enough. Like the unseasonably cool, wet weather we've had on the East Coast this year, the U.S. economy has been dampened in the face of military conflict and a stagnant job market. But could summer heat things up?

During the first quarter 2003, the American consumer plodded along purposefully like a tug breaking the ice on a lake. And capital investment has been grounded in the same way flights were grounded after the President's Day snowstorm that dumped record snowfalls at Boston's Logan International and Washington's BWI airports. Currently, many economic indicators remain weak, but there are signs of life within the frozen economy, including strong productivity gains, steady personal incomes, increased orders for manufactured goods, better export numbers from a cheaper dollar, and a budget stimulus package that will encourage investment and boost employment.

In hindsight, it is arguable that the second quarter of 2003 witnessed a residential construction boom that has yet to peak, a commercial construction depression that may be near to bottoming, and a public construction sector that has started to look like less of a "sure thing." Residential construction has continued at 2002's strong pace primarily because personal incomes remain strong, home prices are moderating, and mortgage rates remain huge bargains. Yet there are a couple of issues to consider — interest rates and tightening lending regulations — that could potentially slow this pace down in late 2003 and 2004. In the opposite way, the commercial sector may begin reviving late this year as

bank credit availability improves with increasing business profitability and fewer high-profile bankruptcies and mass layoffs. These are signs that increased structural investment may not be too far off. This would be welcome since commercial construction has not perked up appreciably due to continued over-capacity and high vacancy rates. Public sector contractors who have up to this point felt immune from the tough economic environment may want to rethink their positions as states and municipalities wrestle with the worst budget outlook in decades and the federal government begins to seriously examine its recent spending patterns.

A DISAPPOINTING START FOR 2003

Business owners, investors, and even consumers pulled back during the first half of 2003 in response to the uncertainty created by the war with Iraq. First quarter employment data took a turn for the worse and this weakness continued into the second quarter of 2003. The current freeze on hiring stems primarily from the prevailing wait-and-see attitude and not as much because more staff aren't needed. The four-week average of initial unemployment claims remain well over 400,000 in late June, which signifies a stagnant labor market. However, initial cliams have been steadily trending downward since early May. In addition, planned job cuts plummeted from nearly 150,000 in April to 68,623 in May signaling a possible end to major downsizing.

WHAT MIGHT TURN THIS AROUND

But mixed in with all of these conflicting employment and confidence data are some indications that they may be a short-term blip and not the indication of a double-dip recession that some suspect.

While much of the data released this year has been disappointing, it is important to note that the economy is still expanding — albeit rather anemically. The output of goods and services produced by labor and property located in the United States increased at an annual rate of 1.6% the first quarter of 2003 up from 1.4% in the fourth quarter 2002. Steady consumer spending, new home construction, and government spending were the main positive sectors. The business sector retreated a little as equipment and inventory purchases dropped and sales from exports dipped.

Some areas of the economy that were weak in the first quarter 2003, like business investment and exports, have resumed their recovery recently while some steady sectors like consumer spending, government spending, and residential construction have held up. This is evidenced by The Conference Board's consumer confidence index, which rebounded sharply from first quarter levels to 81.0.

Economists who have revised their 2003 forecasts down into the low two-percent range must be asked, "Where is the drag on the economy going to come from?" Since the war with Iraq has concluded and consumer confidence has risen, there appears to be a good possibility of high 2% GDP growth in 2003 and high 3% GDP growth in 2004.

One of the main reasons for optimism comes from rapidly rising

work productivity, which heavily influences employment income and business profitability. Business sector productivity increased 4.8% in 2002 over 2001, according to the Department of Labor. This was the largest annual productivity gain since 1950. The 2001-2002 increase reflected a 2.7% increase in output combined with a 2.0% decline in hours. Unit labor costs in the nonfarm business sector dropped 1.9% in 2002, the largest annual decline in this measure ever recorded. U.S. labor productivity growth in 2002 rebounded sharply to 2.8% from 0.4% in 2001 and continues to outpace Europe's productivity gains, according to The Conference Board. The continued weakening of the dollar will also boost exports.

From a production standpoint, all of this adds up to a much improved business environment, and since the president's jobs and growth plan has been passed by Congress, it will act as additional fuel for the coming productivity-driven economic expansion.

CONSTRUCTION OUTLOOK

Construction put in place during April 2003 was estimated at a seasonally adjusted annual rate of $862.6 billion, 0.3% below the revised March estimate of $864.8 billion, according to the U.S. Commerce Department's Census Bureau. The April figure is 0.7% above April 2002.

The war with Iraq may not have been about oil but, in coming months, oil may influence the direction of the U.S. construction industry. Higher oil prices infiltrate all corners of the economy, including construction, and prolonged elevated prices may diminish the outlook for residential, commercial, and even public construction in late 2003 and into 2004. After the price of gasoline broke records in February, prices have come back down to manageable levels. The U.S. average retail price for regular gasoline fell in the first week of May for the seventh week in a row. Over the previous seven weeks, the average price for regular gasoline declined by 21.5 cents per gallon and oil future markets seem to indicate that this trend will continue for a few more months. However, very low U.S. petroleum reserves and high summer demand could put pressure on prices.

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RESIDENTIAL CONSTRUCTION

The residential construction market has been crucial to the construction industry and to the U.S. economy as a whole during the last two years. Plainly, there has been ample demand driven by underlying demographic and lifestyle preferences. In addition, lower mortgage interest rates offset higher home prices and improved housing affordability conditions in the first quarter to the highest level in 30 years, according to the National Association of Realtors.

Short-term drivers for housing construction demand — weather conditions,

consumer sentiment, and builder sentiment — were off early in the year but have since rebounded.

Spending on new residential housing units was at a seasonally adjusted annual rate of $325.6 billion in April, 0.5% (+/-1.6%) above the revised March estimate of $327.3 billion.

The Market Composite Index of mortgage loan applications for the week ending June 13 increased to 1701.7 on a seasonally-adjusted basis from 1684.6 one week earlier, according to the Weekly Mortgage Applications Survey of the Mortgage Bankers Association of America (MBA). The MBA seasonally adjusted purchase index increased to 419.1 from 418.9 the previous week.

Existing-home sales rose 5.6% to a seasonally adjusted annual rate of 5.83 million units in April from an upwardly revised pace of 5.53 million units in March, according to the National Association of Realtors. Last month's sales activity was 3.2% below the 5.66-million unit level in April 2002.

New home sales remained above the million-unit mark in April rising to a rate of 1,028,000 units. This strong showing is a 1.7% increase over March's decline and 12.2% above the April 2002 estimate of 916,000 units. The total months' supply of new homes for sale has dropped below its recent four-month average, down to three and a half months.

Although the residential market remains very strong, the level of mortgage defaults determined unacceptable to bank regulators and the possibility of rising mortgage rates are two potentialities that could dampen the residential construction market in the next 12 months.

Mortgages are hotter than ever, but nearly 80% of their volume has been refinancing. Interest in obtaining financing for a new home is growing less quickly. The market composite index of mortgage loan applications for the week ending March 7 increased to a record high of 1603.1, according to the Mortgage Bankers Association of America. On an unadjusted basis, the index increased by 26.2% and was up 190.1% compared to the same week a year earlier. However, in a separate lending practice survey produced by the Federal Reserve Board, respondents that reported stronger demand for mortgages to purchase homes over the past three months dropped from 40% in the previous survey to 7% in January.

Since January 2001, the number of new mortgage bankers has grown by nearly 125,000, according to the U.S. Department of Labor. This amounts to a lot of new mortgage bankers approving a lot of new mortgages — some to individuals who shouldn't have been approved because more and more of these mortgages have become noncurrent. Noncurrent residential mortgage loans increased by $895 million (6.8%) over 2001 according to the Federal Reserve Board. U.S. home loans in foreclosure edged up to a record level in the third quarter of 2002 as the weak economy forced a larger portion of mortgage holders out of their homes, according to the Mortgage Bankers of America. Loans in the process of foreclosure grew to 1.15% of mortgages, up from a revised level of 1.13% in the second quarter of last year.

Real estate loan foreclosures are being closely watched because they played a large role in the banking recession of the early 1990s when the commercial real estate market collapsed. When real estate prices fell for commercial properties and the market weakened, banks found themselves with inadequate

reserves to cover "bad loans" — and therefore carried nonperforming loans on their books for longer than they normally would. On February 25, 2003, the Federal Deposit Insurance Corporation (FDIC) sent an open letter to banking executives outlining the FDIC's stance on acceptable mortgage banking procedures. It highlighted the agency's "concerns about certain mortgage activities" and reminded bank officers the importance of proper risk management for their mortgage portfolios. In the memo, banks were warned that failure to follow these safeguards may subject them to higher capital requirements, which could put a chill on lending.

The tide of mortgage foreclosures appeared to be waning in the third quarter 2002, but recent stagnant employment growth may cause this number to rise again — possibly forcing the banking industry to change application and approval procedures. Evidence that some banks are beginning to tighten standards on home mortgages appeared for the second consecutive edition of the Federal Reserve Board's January 2003 senior loan officer opinion survey on bank lending practices. The share of banks tightening standards on residential mortgage loans edged up to 11% in January from 10% in the October survey. Notably, these were the first two indications of any noticeable tightening in over a decade.

COMMERCIAL

In April 2003, nonresidential building construction was at a rate of $156.1 billion, 2.6% below the revised March estimate of $160.3 billion. The free fall in commercial construction is likely almost over but, as the first quarter 2003 construction data illustrate, low volumes could persist for an additional year or more, as was the case in the early 1990s.

Because of this potential for persistent weakness, commercial contractors should hope that the president's stimulus package is adopted in the near future because it will pump capital investment money into equipment purchases and building projects where it has been sorely missed during the past two years. Bush's purpose in proposing this plan is not just to deliver a short-term boost to the economy but to raise the growth rate and boost job creation for the foreseeable future. Beneficial effects from the plan would permanently raise incomes similar to how household cash flow is permanently raised from mortgage refinancing.

> ***"When there's an incentive to go out and buy an extra piece of equipment, somebody is more likely to find work on an assembly line, which is making that equipment. And when he purchases the equipment, somebody has got to operate the equipment. So we got a new employee there. And then the company becomes more productive, which means it's more likely to have a better bottom line over time. And when you have a better bottom line over time, it means you're likely to stay in business, so that the people you've hired today are going to have work tomorrow."*** — George W. Bush on the importance of capital investment incentives

Capital investment in new equipment is often purchased first and thus is a strong indicator of increased structural investment a year or two in the future; it indicates improved profit outlooks and a willingness to expand or upgrade productive ability. During the first quarter of 2003, U.S. markets for capital investment goods have bottomed out into their current dormant state. But there are signs of

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stirring. In March 2003, manufacturer shipments of equipment such as computers, software, and nondefense capital goods all increased significantly. Overall, new orders for manufactured durable goods in March increased $3.4 billion or 2.0% to $173.6 billion, according to the Department of Commerce. It was the second increase in three months and handily exceeded the decline expected by many economists.

After sputtering during the winter and spring, this equipment-spending trend may continue. A recent study by Wall Street brokerage firm UBS Warburg has found that businesses intend to spend more on tech products this year than they did in 2002. These results are echoed by a number of other surveys and in slowly improving equipment sales as well as improved manufacturers' and wholesalers' prices for equipment. The Institute for Supply Management reported that non-manufacturing business conditions improved steadily while the business conditions in the manufacturing sector continued to slowly grow during the first half of 2003 in pits and starts. Both neared expansionary levels in May 2003, having expanded for four straight months.

One of the most effective ways to jumpstart the expansion to spur business investment — which, in turn, will lead to continued technological advances and productivity growth — is through an enhanced capital-cost recovery system. Under the Bush plan, the amount of investment that may be immediately deducted by small businesses is increased from $25,000 to $75,000 beginning this year. The amount of investment qualifying for this immediate deduction begins to phase out for small businesses with investments in excess of $325,000, increased from $200,000. An ideal system would allow companies to expense capital equipment in the tax year it was purchased. While the plan doesn't go all the way toward this goal, it is an important step.

A second key element of the plan is the complete elimination of the double-taxation of dividends. Anything you tax more of, you will get less of — including business investment. Today, corporate profits are taxed at the 35% range, and then these profits, which represent the return on business capital, are taxed again when paid to shareholders, so the total tax on this money can be as high as 60%. Most other industrial countries already treat dividends in ways similar to what's proposed.

The constriction of commercial and industrial financing at banks, especially to smaller businesses, appears to have peaked after growing in response to ballooning corporate lending problems in 2001. According to the Federal Reserve Board's January 2003 senior loan officer opinion survey on bank lending practices, the net fraction of domestic banks that reported tightening standards on commercial real estate loans over the past three months slipped from 22% in October to 14% in January. An explanation for this

decline is that commercial and industrial loans considered noncurrent declined by $1.2 billion in the fourth quarter of 2002 — the first overall noncurrent drop since the fourth quarter of 1999, according to the FDIC. Banks and thrifts set aside $13.7 billion in provisions for loan losses in the fourth quarter, $2.5 billion (15.7%) less than a year earlier, when large banks had sizable provisions for troubled loans to large corporate and foreign borrowers. This is the first year-over-year decline in quarterly loss provisions in more than three years, since the third quarter of 1999.

During 2002, according to the FDIC, the quality of large commercial bank loans continued to deteriorate but at a slower rate than was evident in 2001. Total loan commitments classified as either substandard, doubtful, or a loss rose by $39.4 billion or 34% over the previous year, compared to a net increase of $54.3 billion or 86% the year before. Deterioration since the middle of 2001 was largely driven by the pronounced problems in the telecommunication sector, alleged corporate fraud, weakness from the most recent recession, and the after-effects of September 11th.

IMPACTS OF THE TRAVEL RECESSION ON CONSTRUCTION

Construction sectors like hotels and amusement facilities that are dependent on travel are facing a slow recovery. Total U.S. tourism industry sales decreased 3.2% (seasonally adjusted annual rate) to $708 billion in the first quarter of 2003, according to the U.S. Bureau of Economic Analysis. Although tourism continues to recover from its fourth quarter 2001 trough, it remains well below its pre-September 11, 2001, peak. For the year 2002, total U.S. tourism industry sales decreased 0.5% to $706.7 billion. Transportation employment, primarily air travel, declined by more than 30,000. Since January 2001, job losses in the transportation industry have totaled nearly 300,000.

Construction of amusement and recreation facilities will also likely finish 2003 lower because of reduced public and private funds available and a still weak economy, in addition to reduced leisure travel — especially over long distances. The value of amusement and recreation spending was $17.2 billion in April 2003, 5.7% less than during April 2002 and amusement and recreation services and hotels and lodging places each fell considerably short of their normal spring hiring. Spending on high profile, alumni pleasing construction projects like university stadiums and public art galleries did well in 2002, but that probably won't be repeated in 2003. For private, higher education, spending on these projects grew by nearly 30% last year. But with state funds being fought over and philanthropist fortunes wrecked by the stock market, it's doubtful that this part of amusement and recreation construction will grow during 2003. In fact, state governments across the country are considering eliminating funding for the arts entirely, to help to bridge some of the worst budget deficits in decades. At least three states have put forward plans to suspend all funding for cultural organizations for the foreseeable future with the burden of funding falling squarely on patrons and donors.

Travelers and vacationers will likely purchase less gas in coming months primarily due to its recent spike in price. But even if gasoline prices continue to edge back down as they began doing in late March, drivers may stick close to home in coming months as the nation continues to hold its collective breath over a

shaky economy, terrorism, and poor employment growth. For example, Disney executives have lowered profit outlooks because they project that these concerns will continue to hurt business at theme parks. As a predictor of summer travel activity, TIA's traveler sentiment index rebounded slightly in the first quarter of 2003. The overall index now stands at 95.7, down slightly from the first quarter of 2003's flat results. This drop is due primarily to consumers feeling that they had less time available to travel. Unfortunately, fewer people doing more work would seem a plausible explanation for this decreased free time.

The global recession, war and terrorism fears, and rising animosity toward Americans have deeply hurt the air travel industry as witnessed by the narrowly avoided bankruptcy of American Airlines. Unfortunately, these factors have been joined by another dreadful problem — a deadly new transmittable virus that has caused extraordinary travel restrictions, especially in the Far East. In late March, the World Health Organization (WHO) ordered all airlines with international flights leaving affected areas — Toronto, Hong Kong, Singapore, Hanoi, Taiwan and Guangdong province, China — to begin screening passengers. Although SARS appears to have waned, it and other communicable diseases will continue to affect international travel.

PUBLIC SECTOR CONSTRUCTION

In March, the estimated seasonally adjusted annual rate of public construction put in place was $201.2 billion, 0.2% (+/-4.6%) above the revised March estimate of $200.7 billion. Public sector construction has been less prone to cyclical swings in the past but, lately public sector builders have not felt as insulated from the recession that has affected commercial builders so deeply. Spending by state and local governments has grown nationwide without interruption for decades, in good times and bad times alike. It has not fallen since 1944, and it has grown faster than the rate of inflation every year since 1982. These streaks will probably be broken in 2003.

Public sector projects continued largely unabated in the last year or two even after it became clear that government tax revenues were declining while expenditures (transfer payments and other assistance) ballooned. This was partially due to the record-breaking volume of bond issues in 2002. Total municipal bond issuance reached a record $430.7 billion in 2002, an increase of over 25% from 2001. Also, spending held up because many of the state budget cuts that were reported were not declines in present spending levels but, instead were reductions in planned spending increases that were approved when the U.S. economy was booming — phantom cuts. This year however, the outlook is for a lower volume of municipal bond issues and for states and municipalities to face many more tough spending choices. Often that has left public sector builders and their allies to frantically struggle in order that their projects not be the ones delayed or shelved all together.

Just as states and municipalities have already begun tightening their belts, there are indications that the federal government won't spend freely forever either due to predicted lower debt issue volumes and higher deficits in 2003. Gross coupon issuance in the U.S. Treasury market totaled $571.6 billion in 2002, up a remarkable 50.2% from 2001, according to the Bond Market Association.

Responding to this large increase in debt, House Republicans unveiled a budget in early March that proposes deep cuts in federal spending to fight rising deficits and pay for big new tax cuts requested by President Bush. The plan, which the House Budget Committee is expected to clear, would cut spending by some $570 billion more than Bush has proposed over the next decade, while accommodating much of the tax cuts he is seeking. Faced with that grim outlook, House Republicans vowed to bring their own budget back into balance by 2010 by rounding up those usual suspects "waste, fraud, and abuse" in government programs. The government sector was one of the largest sources of planned job cuts this spring according to Challenger, Gray & Christmas.

HIGHWAY CONSTRUCTION

FMI's outlook for U.S. highway construction during the remainder of 2003 and into 2004 is mixed. Federal highway funding appears to be heading in the right direction, with encouraging support from both sides of the isle in Congress. White House officials have put up considerable resistance to increased federal highway funding but will likely compromise given its need for congressional support in coming months. However, finances are in such bad shape in most states that capital improvement projects like roads that have usually been off the table during budget cutting periods may not be exempt this time. Exacerbating this would be lower-than-expected gasoline excise tax revenues this summer that could further limit highway construction funding. High gas prices would be the primary culprit behind these revenue losses but increasingly conservative consumption and travel patterns stemming from the flat economy and the war may also be factors in reduced gasoline excise tax revenues during the peak driving months.

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For the remainder of this decade, House of Representatives Transportation and Infrastructure Committee leaders are pushing a transportation investment plan that will increase investment levels for the federal highway, mass transit, and safety (NHTSA and motor carriers) programs from $50 billion in fiscal year 2004 to $75 billion in fiscal year 2009, according to ARTBA. These steps are encouraging, but increased federal funding is only part of the equation and other components like state transportation spending and fuel tax revenues don't appear as promising.

State governors have voiced support for increased federal highway funding and have agreed that fuel taxes should only be used for transportation purposes. However, state governments are being buffeted by all sides: declining payroll tax revenues, rising health care costs, and steep declines in capital gains and corporate profit tax revenues. These factors have caused state revenues to decline 6.3% in

2002 — the first full year that states have witnessed a decline in revenues for as long as credible statistics are available back to World War II. As they prepare their fiscal year 2004 budgets, states will be faced with closing both the newly emerging gaps for the 2003 budget year and the huge new deficits for 2004 since 49 states are required to balance their budgets. Budget deficits are expected to be in the range of $70 billion to $85 billion for state fiscal year 2004 and represent between 14.5% and 18% of all state expenditures, according to the National Governors Association. These new deficits are on top of the $50 billion in deficits that states closed when they enacted their fiscal year 2003 budgets and are twice as deep as the amount states face during the last recession.

This means that states will be forced to use some combination of cuts in programs and revenue increases to close gaps that on average represent at least one dollar out of every eight dollars of expenditures in their budgets, according to the Center on Budget and Policy Priorities. With stories surfacing of states saving money by releasing prisoners from jail and of eliminating cultural and arts programs entirely, transportation funds may be too enticing for some states to resist. Others will hope that fuel excise taxes will come to the rescue. But is that realistic in today's climate? Although most states primarily rely on sales and income taxes as the mainstays of their tax systems, the amounts gathered from fuel excise taxes have grown during the last decade. This has accelerated in the last two years, as some states became desperate for additional funds. But high gasoline prices and conservative travel patterns may put a serious crimp in this source of revenue.

CONCLUSION

Builders this spring felt the impacts from the war with Iraq, and it will continute to have far-ranging effects on the U.S. construction industry and on the U.S. economy. The standing and prestige of our country are on the line because, to some degree, this war and post-war stabilization will influence what the rest of the world thinks about who we are and how we go about things. It was easy to see images of war on TV and worry. But, if you had looked closer, there are other more positive observations that one could have made.

The Gulf War II, as it is sometimes called, vividly illustrates just how far American capabilities have come in just a decade after Gulf War I. The first Gulf War is considered by many to be one of the greatest military victories of all time, but the current military campaign, Operation Iraqi Freedom, has adopted the latest technologies and management strategies to better achieve its strategic objectives this time around. Contrast slowly building up 500,000 men for the purpose of conducting a top-down WWII style campaign in the Gulf War I to the recent last-minute, 'turn-on-a-dime' change in plan to strike Iraqi strongholds with cruise missiles and to limit the Shock and Awe campaign and its ensuing casualties. Improved teamwork, training, and motivation; vastly improved communications ability; and upgraded technology like the Patriot missile and GPS guided Tomahawk missiles are more examples of our improved war-waging capability. After studying these strides, its not difficult to see how these revolutions in management science and technology are mirrored in increased American business productivity gains and how we will all benefit from these in the years to come. ■

Assessing Your Alternatives

A systematic process provides the necessary pre-planning to answer the inevitable question: Should we expand the business?

By Jay Bowman & Randy Giggard

If profitable growth is one of your principal goals, then you will inevitably face the question of how to expand your business. Expansion can take multiple forms. Expanding your served market segments, product mix, or the penetration of existing markets are all examples. The framework discussed here is directed specifically for geographic market expansion, though the general principles described can be equally applied to other forms.

In our work with the construction industry, FMI has seen thousands of companies struggle to grow profitably, with varying degrees of success. In our experience, those who have been most successful, have done a superior job of market assessment and planning on the front end. We aim to help you think through the key issues impacting alternative geographic expansion opportunities.

Geographic expansion questions are typically raised in response to rising earnings targets, competitive pressures, or anticipated weakening or saturation in existing markets. Well-meaning firms with a bias for action are too often enticed by what they want to hear. After cursory review of market data from local newspapers, business journals, and financial institutions, these firms begin to leap directly into uncharted waters.

Key questions will be answered in any business expansion process. However, it is highly preferable to secure and understand the answers before commitment of

financial, material, and human resources or reputation. Some of the questions to consider include:

EXTERNAL/INDUSTRY-RELATED:

- What is the real potential in this market today vs. three to five years from now?
- What are the key local industries during the local economy?
- Who are the key buyers of construction products and materials? Are their businesses healthy?
- What are local business leaders and government officials doing to promote growth?
- What is the regulatory environment?
- What taxes can be expected? Are incentives offered?
- Is local labor available? With what skill sets? At what rates? Union/non-union posture?
- Who are the leading competitors? How are they organized and structured? What are their strengths, weaknesses, and capabilities?
- What do key local buyers want that they're not getting from current suppliers?
- In what ways might existing competitors be vulnerable?
- How intense is local market competition? How will they likely respond to your entry?

INTERNAL/COMPANY-RELATED:

- How well is our current business strategy working?
- What are our own strengths, weaknesses, opportunities, and threats?
- How competitive are our costs and prices with existing firms in the market?
- How easy is it for you or anyone else to enter this market? What are the barriers?
- What are our distinct capabilities? How do they provide us a sustainable competitive advantage?

It will help to consider these questions through a series of five determiners of attractiveness shown in Exhibit 1.

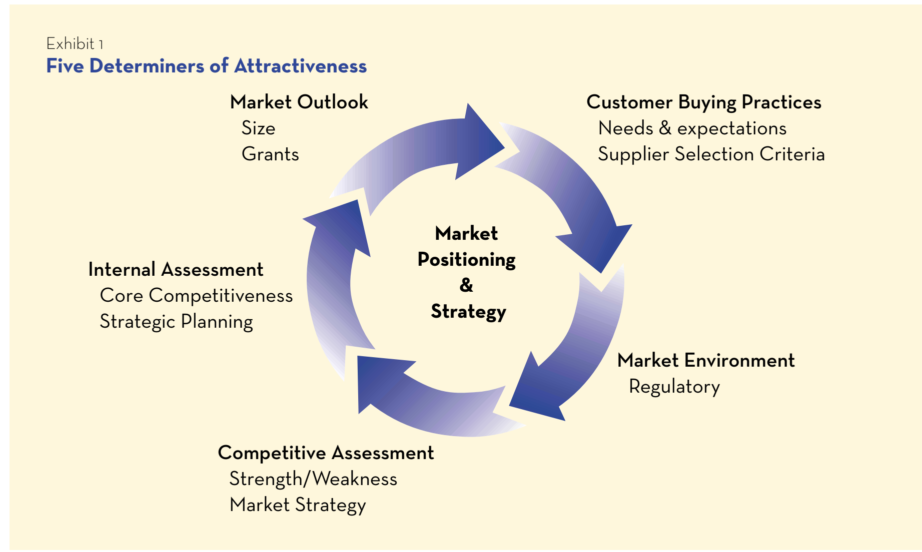
Market attractiveness is ultimately determined by the balance of multiple factors. For example, the market outlook for growth may be superior, but irrelevant if other factors are negative. It then follows that strategy development is irrelevant until all five factors are clearly understood.

Accuracy in your assessment of the expansion opportunity will be largely dependent on your ability to realistically view what it would be like if you were already there. An intimate knowledge of the local environments (e.g. economic, political, regulatory, competitive, labor) is gained by answering the questions detailed previously, with the ultimate objective of answering one bottom line question:

"Will my company enjoy a sustainable competitive advantage in this market?"

This discussion may conjure up visions of MBAs espousing theoretical approaches and models. In truth however, this requires a very "earthy" hands-on

Exhibit 1
Five Determiners of Attractiveness



approach. Some of the most important information is likely to lie below the surface in local stakeholders' attitudes and perceptions. Effectively researching this information requires a combination of techniques as well as experienced interpretation of how these pieces fit together in the construction environment. We suggest a methodology that includes the steps shown in Exhibit 2:

Exhibit 2
A Study of a Geographic Market Expansion Opportunity

Market Outlook	Customer Buying Practices	Market Environments	Competitive Assessment	Internal Assessment	Market Positioning & Strategy
Market size and metrics based on qualitative secondary research	Market issues and needs viewed through the eyes of the customer	Analysis of current and projected business climate	Profiling of competitive strengths, weaknesses, and apparent strategies	Review of internal strengths, weaknesses, and core competencies	Development of an effective path forward

STEP 1: MARKET OUTLOOK

This initial step involves extensive secondary research of available market data using both print and electronic resources. Some of these sources will typically include government publications; construction market forecasts; and reports from financial institutions, the local chamber of commerce, and economic development groups. Local news reports, business journals, and project announcements should be searched.

This step usually begins with a local market forecast for construction, including several years of history and a three- to five-year forecast. Exhibit 3 shows the total amount of construction put in place for a sample city.

In addition to market size estimates, the secondary search will identify factors potentially impacting local growth trends such as demographics, labor posture, major local contractors and design firms, and major programs either announced or being considered.

Exhibit 3
Privately-Owned Construction Put in Place
Estimated for Sample City
$ Millions

Residential Buildings	1998	1999	2000	2001	2002	2003	2004	2005
Single-Family Houses	1,708	1,965	2,009	1,987	2,213	2,315	2,249	2,388
Two-Family Buildings	21	11	9	7	9	8	8	9
Three- and Four-Family Buildings	7	5	6	5	5	5	5	5
Five-or-More Family Buildings	96	152	176	111	97	66	65	70
Total Multi-family	124	169	191	124	112	79	78	84
Total New Residential	1,832	2,133	2,200	2,110	2,325	2,394	2,327	2,473
Residential Improvements	628	691	777	825	869	879	863	909
Total Residential	**2,461**	**2,824**	**2,977**	**2,936**	**3,194**	**3,274**	**3,190**	**3,381**

Firms sometimes have a tendency to be overly focused at this point based on limited information. For example, a firm may ask a third party:

"We currently have five plants on the West Coast, and we're considering expanding into Phoenix. What do you think?"

Now Phoenix may, in fact, be a good choice. On the other hand, areas not being considered such as Las Vegas, Denver, or Sacramento might be even better choices for this company. This initial phase is often best structured as a preliminary screen to ensure that the appropriate baseline of options is considered. The baseline of options in a geographic expansion is typically comprised of alternative cities. However, the baseline might also involve options such as make vs. buy, alternative services to be offered, or a market segment focus. It is reasonably easy to develop weighted attractiveness criteria to surface the best opportunities for further analysis once the full range of options has been fully explored.

STEP 2: CUSTOMER BUYING PRACTICES

The next three steps deal with how the local market actually functions. Customer buying practices are normally addressed first because these results generate preliminary insight into environments and competitors.

The aim is to assess the market from the customer's perspective. What are their key issues, needs, concerns, and expectations? What selection process are they using and with what criteria? What terms and conditions are preferred? How loyal are buyers to a particular producer or brand, and will they switch?

Access to distribution channels is often the make or break issue for many companies venturing into new markets.

This analysis should be developed using a combination of blind-written surveys and interview techniques. The written surveys support development of a broad base of quantitative customer data. For example, customers will rate how important various criteria are in their supplier selection process, and then what their experience has been with respect to supplier performance.

In Exhibit 4, this supplier received an average rating of five and an overall score of 50% (25 out of a possible 50 points).

By asking customers to identify and rate characteristics for specific preferred suppliers, it is possible to develop highly revealing profiles of perceived competitive strengths and weaknesses. Customer ratings for the importance and performance of specific competitors against key selection criteria can be plotted to reveal opportunities to be exploited.

It is important to realize, however, that written surveys are limited in their ability to tell the whole story. Critical information of a more qualitative, perceptual nature will remain below the surface. It is also quite normal that new questions are raised by the written survey results. We then use follow-up interviews to validate survey results, drill down further into the underlying issues, and expand on the results. Depending on the size of the market and questions remaining, conducting 10 to 30 "drill-down" interviews may be appropriate.

Exhibit 4

Rate Your Current Supplier Against the Following Factors

Scale: 1 (poor) to 10 (excellent)

Factor Supplier	Rating	Comments
1. Quality of product	3	"Excessive defects, we had to keep replacing it."
2. Ease of use/installation	4	"Okay, better tools would improve handling."
3. Price	5	"In line with my other suppliers."
4. Delivery	6	"Always has product when I need it."
5. Helpfulness of sales rep	7	"Keeps me up-to-date on new products."

STEP 3: MARKET ENVIRONMENTS

The market environment provides a critical context in which to view secondary research and customer research results. A market environment assessment presents a current and projected view of the business climate, including labor availability and rates, legal and regulatory issues, business development initiatives, tax policy, and infrastructure. In other words, what are the drivers of change in this market?

For a product manufacturer, distribution channels present the path of product flow from production to the end user. This is not unique to manufacturers though. Even contractor services can move through "distribution channels," including general contractors, construction managers, or architects.

Access to distribution channels is often the make or break issue for many companies venturing into new markets. Will you be able to access customers? Local distributors may be reluctant to support a product that lacks familiarity in the market. Furthermore, local producers may be using all of the available distribution channel supply. At this point, you must now consider developing your own channels of distribution if they do not already exist.

Some of the information concerning local business practices will have surfaced, at least on a preliminary basis, through the primary and secondary research developed up to this point. This is the time to dig deeper to validate what you think you know, and to understand what's behind it. Primary research interviews are the best vehicle to reach this information. These may be conducted using telephone techniques,

though a mix of face-to-face discussions is preferred. While the cost of traveling is higher, you will always get more attention and develop a better "feel" for difficult issues such as provinciality. Human beings have a natural tendency to be more receptive toward people who are like themselves. If provincial attitudes will pose a barrier to you as an outsider, understand and plan for it in advance.

Key sources for market environment assessment may include contractors, engineering/architecture firms, government and planning officials, local business leaders, financial stakeholders, competitors, and suppliers.

STEP 4: COMPETITIVE ASSESSMENT

As with market environment issues, several competitive insights will be developed before getting to this point. The first two questions you must answer are 1) how many rivals will I have in this market, and 2) what is their relative size? Assessing the "pond" will tell you fairly quickly if you will be a big fish or a little fish.

Generally, it is useful to develop additional information concerning specific competitors to fully support your strategy development. A profile of each targeted competitor might include:

- Available financials or reasonable estimates
- Growth history and projections
- Business composition by product mix and markets served
- Degree of integration
- Pricing and delivery strategies
- Performance strengths and weaknesses
- Perceived niche capabilities and expertise
- Identification of key management personnel and their competence
- Key customers by volume
- Apparent market strategies.

Developing competitive intelligence is an art in itself, requiring secondary research skills, and the ability to quickly formulate follow-up interview questions. Important information concerning strategies, performance, and capabilities can be gleaned from customers, suppliers, subcontractors, other competitors, and business leaders — often in conjunction with the preceding customer and environments research.

The decision to expand your business geographically is an important one, putting both resources and reputation into play.

STEP 5: INTERNAL ASSESSMENT

This part of the process is sometimes the toughest, requiring an unbiased appraisal of your internal strengths and weaknesses. What are your core competencies? What can you bring to specific market segments? Where are you vulnerable? Try to separate yourself from the way you

talk about your capabilities to potential customers. It may be useful to gather some honest input from your own customers, suppliers, and distributors.

We recommend that this internal check include information from varied levels in your organization. There are often revealing differences that, while painful, are better addressed now than after investing in an expansion.

The assessment may be conducted through personal interviews of your organization's members and of your customers, suppliers, and distributors. Alternatively, it may surface as part of strategy development sessions.

STEP 6: MARKET POSITIONING AND STRATEGY

This final step will include a thorough review and discussion of the findings to this point. Your team will need to sort through a considerable amount of information, potentially conflicting information, to determine the critical factors. Before making a go/no-go expansion decision, your team should reach consensus on at least two critical issues:

1. Do specific niches of opportunity exist in this new geography?
2. Will you be able to sustain and differentiate yourself in reaching those niches?

Your sixth step is to develop an entry strategy, account strategies, and a specific action plan with timetable and accountabilities.

The decision to expand your business geographically is an important one, putting both resources and reputation into play. This process has proven highly successful for many of our clients. It is a flexible process. For example, it may be possible to compress the steps based on existing knowledge. Your internal staff may be well suited to develop some of the information. In other phases of the work, it can be valuable to draw on the resources of an independent third party. In either case, your pre-planning will be repaid many times over in reaching more informed, fact-based geographic expansion decisions. ■

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Finding Good Customer Prospects During Tough Economic Times

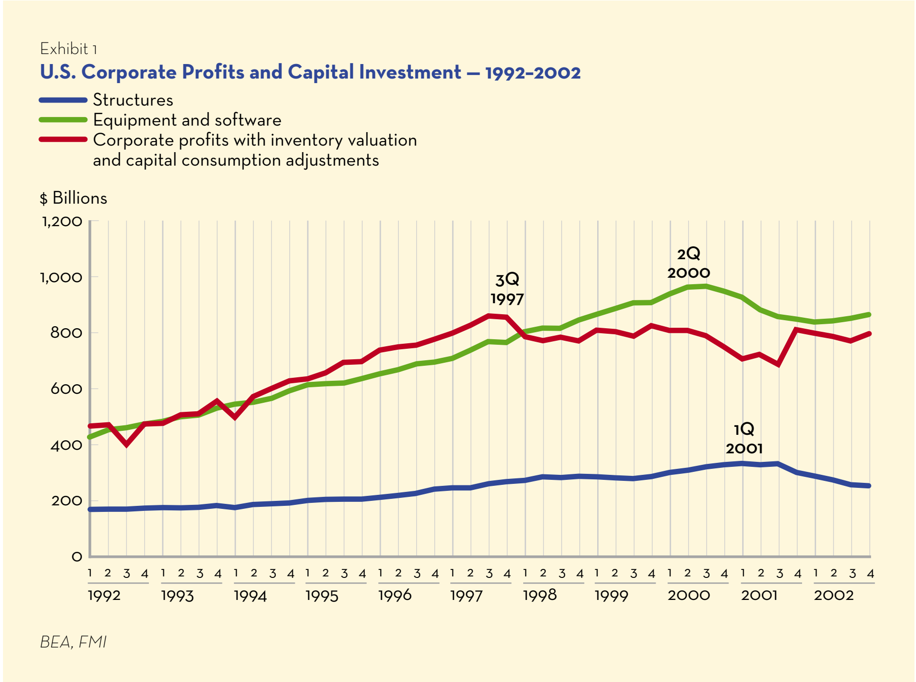
All commercial building owners are not created equal. Commercial contractors should monitor equipment investment and spending and pursue firms likely to need their services.

By Tim Aylor

Commercial contractors should watch equipment investment as a leading indicator of construction spending. This information alone can improve your chances for success — by enabling you to target businesses that will be more likely to expand or improve facilities early in the coming economic expansion.

After surviving a calamitous year like 2002, commercial contractors must be scratching their heads and wondering which, if any, owners will wish to build. The key is to find owners in those commercial sectors that are, or will soon become, profitable. These firms are more likely to need your services within a year or two. But this does not mean switching to school construction if you build offices or switching to hospitals if you build manufacturing facilities. Even during such a dreadful year as 2002, nonresidential builders found business if they knew where to look. One method is to follow which commercial sectors are investing in new equipment and software.

U.S. businesses invested $1.1 trillion in new and used capital equipment in 2001 — a 4% decrease from the previous year, according to the Commerce Department. This should have been a warning sign as this followed an average overall increase of 10% in each of the previous three years and was the first decrease in equipment spending in nine years. Builders taking note of this sign would have been able to predict 2002's drop in commercial building.



A large decrease in equipment spending caused this decline in 2001. However, note that 2001's spending on structures, $362 billion, was about the same as the prior year. Because *new* structural investment has a much longer lead-time from purchase decision to utilization than equipment, structural investment usually lags behind equipment spending. The following are some specific examples of nonresidential construction sectors that bucked the trend to cut equipment spending in 2001 and thus turned out to be growth markets for commercial builders in 2002.

BANKING

The value of financially-related, or bank office construction grew by almost 12% in 2002 after no drop off in capital investment in 2001. This shouldn't be surprising since financial services, especially banks, have enjoyed surprising health in recent years. In fact, banks are one of the few sectors that have higher profits now than before the recession. The industry posted its four highest earnings quarters ever in 2002, as net income for the year soared to $105.4 billion, surpassing the previous year's results by $18.1 billion (20.8%) according to the Federal Deposit Insurance Corporation (FDIC). The industry's return on assets (ROA) in 2002 was a record 1.31%, eclipsing the high of 1.25% reached in 1999, and well above the 1.14% ROA registered in 2001.

Outlook: Fairly positive with continued strong income streams from consumer lending and from a steep yield curve. Slowly decreasing portfolio risks from consumer lending and decreasing portfolio risk from commercial and industrial lending. Residential mortgage risk may elevate moderately as defaults rise from a slowing housing market and continued poor employment growth.

AUTOMOTIVE (SALES, SERVICE, AND PARKING)

The value of automotive commercial construction grew by 8% in 2002 with automobile sales construction growing by 17.5%. This healthy growth in the

otherwise slow growing retail sector stems from the strong sales and profitability at dealerships during 2001 when dealers had their second best year in history, selling more than 17.1 million units, according to the National Automobile Dealers Association (NADA). That performance is beaten only by sales in 2000, which set an all-time record at 17.35 million units of light vehicles sold.

Outlook: Steady personal incomes, great financing, and incentives have continued to spur sales for what Americans live in — their cars and their homes. But have dealers borrowed from future sales when relying on promotions and zero percent financing to draw crowds? And how high will gasoline prices have to go before Americans' love affair with SUVs and trucks ends?

HOSPITALS & HEALTHCARE

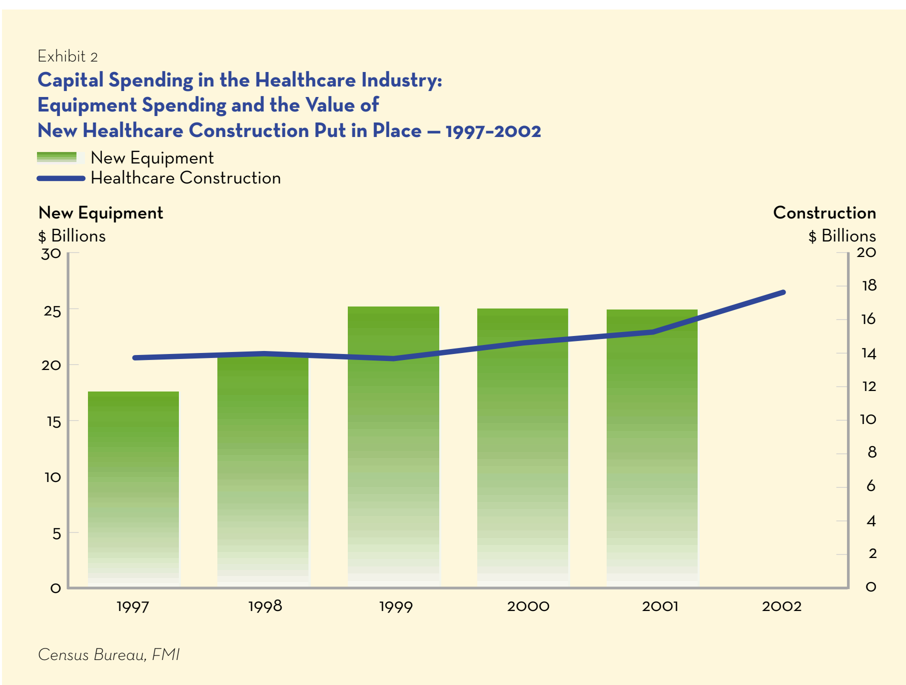
The value of health care construction grew by 15.2% in 2002, with hospital construction growing by 21.5%. U.S. spending on health care rose to $1.4 trillion in 2001, posting the biggest percentage increase in 10 years, according to a report from the Health and Human Services Department.

Hospitals spent a lot more money in 2001. Spending by hospitals rose 8.3%, totaling $451 billion. Much of this went to workers. Hospital employment grew 2.3%, and average hourly earnings for private hospital workers rose 6.1% in 2001. That compares to a 4.1% increase in average hourly earnings for all private workers. Spending on physician and other clinical services rose by 8.6% in 2001, to $314 billion.

Outlook: Like labor, capital often runs to healthcare when other sectors sour and that is what has happened in the last two years as hospital employment and construction projects have both climbed. However, in February, health services recorded its smallest monthly employment increase since 1999. While this might not be a trend, hospital growth may level off as the economy recovers and labor and capital migrate back to other sectors like manufacturing or retail. In addition,

Exhibit 2

Capital Spending in the Healthcare Industry: Equipment Spending and the Value of New Healthcare Construction Put in Place — 1997–2002



Census Bureau, FMI

philanthropy and government money for additions and new projects will likely dry up during the "Great State Budget Crisis of 2003."

DRUG STORES

The value of drug store construction grew by 39.3% in 2002 on the coattails of a number of favorable trends. According to a report from the Health and Human Services Department, prescription drugs accounted for $140.6 billion of the total U.S. health care budget in 2001 and looms as a large and growing part of household and government budgets. Secondly, drug stores are often discounters of many household and food items and closely resemble another successful retail type — the "Wal-Mart" style mass distributor. In addition, the recent popularity of building or remodeling traditional shopping centers has favored drug stores, which are often built as a primary or secondary anchor for these projects.

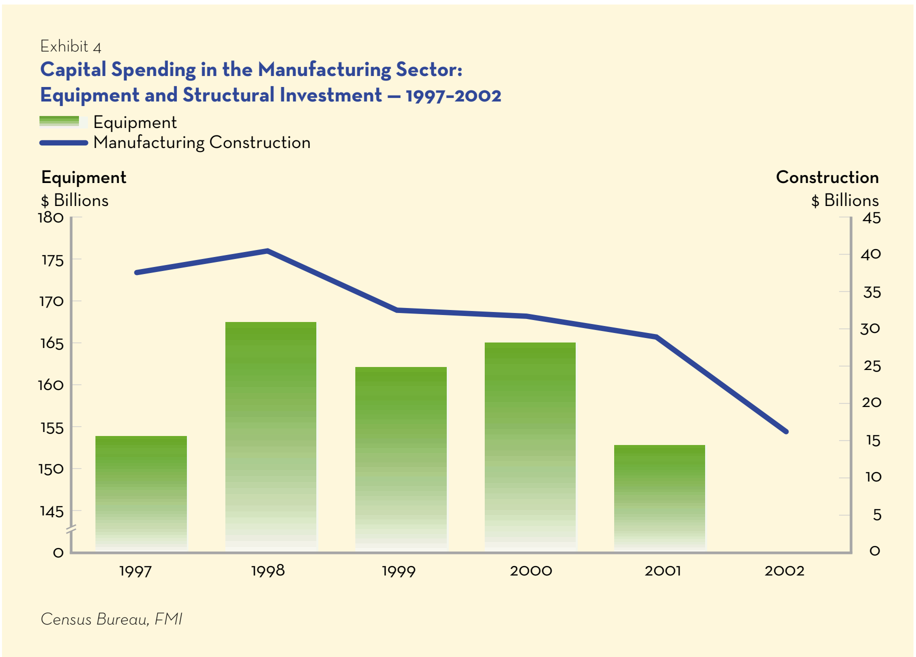
Exhibit 3
Retail Sector Capital Investment: Equipment Spending and Store Construction Put in Place — 1997-2002

Census Bureau, FMI

Outlook: The aging of the population and the continued rolling out of amazing new drug treatments should keep drug stores busy in coming years. For example, CVS Corp., the second largest U.S. drugstore chain, reported that its earnings rose nearly 12% in the second quarter 2003 as it benefited from a push into new growth markets that have burgeoning retirees in migration. The National Retail Federation predicts that over all U.S. retail sales (excluding cars and food) in 2003 will be 5.6% higher than in 2002 when they rose 5.4%. Sales trends should parallel overall economic activity and improve during the year.

CHEMICAL MANUFACTURING

Recovering from a poor 2000 and 2001, the value of chemical manufacturing facility construction increased by 11% in 2002, making it one of the rare exceptions in a disastrous year for industrial builders. But, here again, it was somewhat of an



exception when it came to capital investment in the prior year. While overall manufacturing capital investment decreased 10% to $192 million in 2001, spending by pharmaceutical and medicine industries increased about 14% during that same time period. Venture capital has mirrored this interest in the life sciences (biotechnology, medical devices, and healthcare services) and represented 23% of all venture investment in 2002.

Outlook: A drop-off in profits during 2002 could slow investment plans but the industry should right itself in 2003 with new drug treatments coming online, most of which will be free of competing knockoff products. For example, wholesale drug sales in March were up 8.8% over March 2002. Similarly, industrial chemical orders should continue to increase as the manufacturing sector slowly rebuilds material inventories and limps toward recovery. Shipments of basic chemicals rose to $37.7 billion in March, its highest level since March 2001, while wholesale chemical sales rose 12.6% over the same month in 2002.

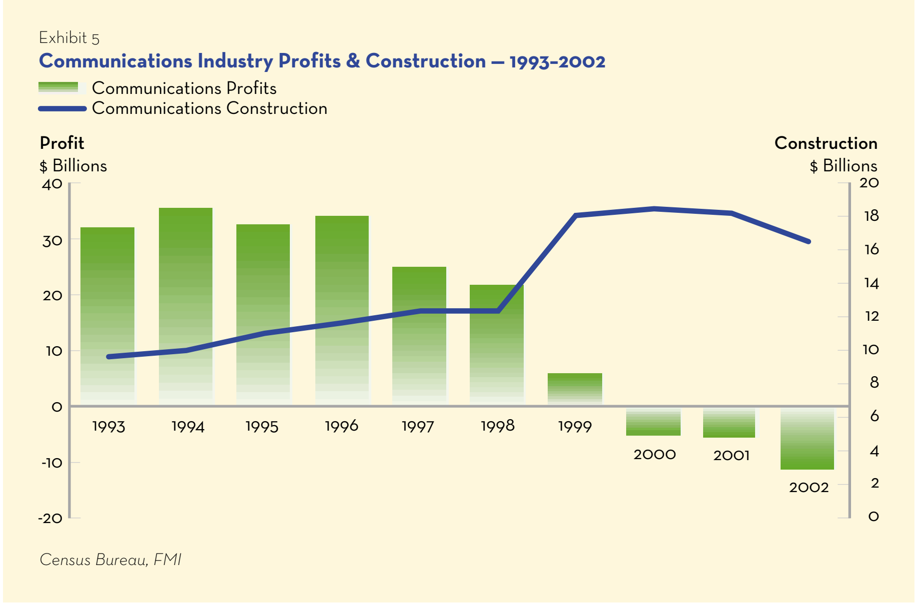
A NOTEABLE EXCEPTION: TELECOMMUNICATIONS

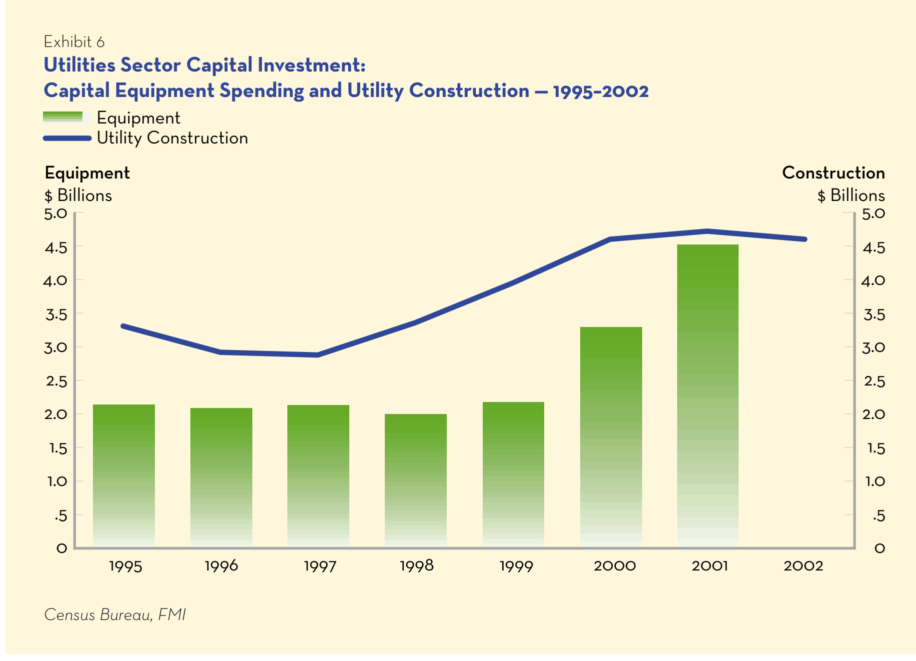
After heavy capital investment spending during the past few years, the value of communications and power construction put in place was $48.1 billion in 2002, down 3.4% from 2001. This is a rather mild decline considering the massive spending on capital investment during the years leading up to that point, a parade of bankruptcies and scandals, and the amount of productive capacity available now. In 2001, the wired telecommunications carriers led utility spending on capital with $74 billion. Wireless carriers followed, spending $24 billion.

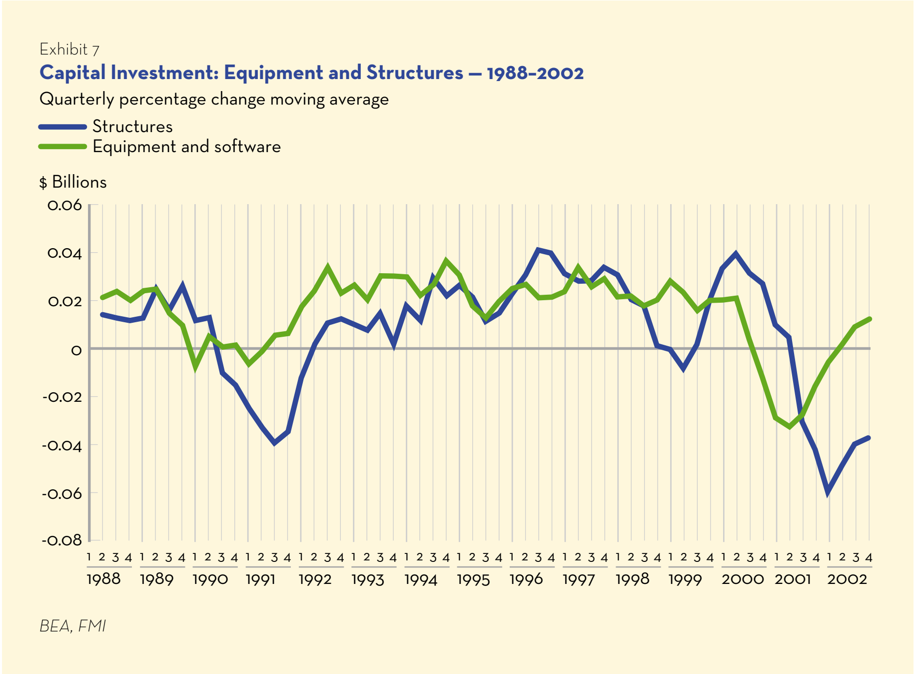
Outlook: Although utility construction volumes remained remarkably steady over the winter, the precipitous drop in corporate profits and employment in the utilities sector in 2002, especially in telecommunications, points to lower construction volumes during the remainder of 2003 and into 2004. Communications industry profits declined from $35.2 billion in 1996 to a loss in 2002 of $11.7 billion.

Telecommunications employment struggled more than any other sector of the economy in 2002, announcing 268,857 planned job cuts — 57% of all high-tech job cuts, according to outplacement firm Challenger, Gray, and Christmas. The string of job losses in communications that began at the same time as the 2001 economic recession has continued, with an additional decline of 7,000 in February 2003, according to the Bureau of Labor Statistics. What the high tech and communications industries need — more equipment investment by businesses — has begun taking place but it may be too little, too late to justify communications construction growth this year or next.

Like sailors long at sea searching the horizon for landfall, commercial builders in 2003 should closely follow the level of equipment investment by businesses in coming







months. Equipment spending by business is important because it indicates improved profit outlooks and a willingness to expand or upgrade productive ability and, as such, is a strong indicator of increased structural investment a year or two in the future.

A significant increase in U.S. equipment investment may signal a commercial investment turn-around in 2004. During the first quarter 2003, U.S. markets for capital investment goods have bottomed out into their current dormant state. But there are signs of stirring. A recent study by Wall Street brokerage firm UBS Warburg has found that businesses intend to spend more on technology products this year than they did in 2002. These results are echoed by a number of other surveys as well as by slowly improving equipment sales and improved manufacturers' and wholesalers' prices for equipment.

In March 2003, manufacturers' shipments of equipment such as computers, software, and nondefense capital goods all increased significantly. New orders for machinery increased by 3.7% in March while machinery shipments rose to $22.3 billion — the largest increase since May 2002. In addition, capital equipment manufacturers finally saw improved pricing power judging by the 0.7% increase in producer's prices of capital equipment in January. Although prices for finished capital goods softened later in the first quarter, they appear now to be firming again.

Builders should take the knowledge that companies are beginning to spend and do some detective work. Find out who is buying. Go to the local chamber of commerce and find out who seems to be having a good year. Or go to local labor supply outfits in your area and ask who seems to be taking on more staff. There's a good chance that with a little digging, you will find out who will soon need your services. ■

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Coaching Organizational Players

Corporate coaching is a valuable tool for the development of leadership talents. All parties — the organization, the coach, and the player — benefit from this unique relationship.

By Tom Alafat, Tony Bell, & Vanessa Winzenburg

James Belasco writes, "Coaching is destined to be the leadership approach of the 21st century." While the overall impact and value of coaching is gaining solid appreciation, some leaders continue to question its value to their companies. They wonder why they should invest in coaching and why it is necessary to institute a leadership development program. At the same time, those leaders who are currently investing time into coaching need to know what's in it for them. Why should they take on another responsibility when they struggle to keep up with their current demands?

The answers are liberating. Indeed, coaching could not be more of a win-win situation for both the organization and the coach. Research on coaching has found that the organizational benefits are huge, and that the payback for the coach is life changing — not to mention the dramatic impact that good coaching can make on the player. These direct benefits of coaching make it a win-win-win. Our focus in this article is to describe all three wins: the benefits to the organization, to the player (the person being coached), and to the coach.

THE ENORMOUS PAYOFF FOR YOUR ORGANIZATION

Developing leaders is increasingly being recognized as a critical competitive advantage. The research supporting coaching is becoming more compelling, so much so that companies that are aware of the research and that have experienced the benefits of leader development conclude that they cannot afford not to fund it. The following are just a few examples from current research.

Nortel Networks, a Fortune 500 company, and Pyramid Resource Group, a coaching services company, retained MetrixGlobal to identify the business benefits and return on investment (ROI) derived from an executive coaching program. Their conclusions were dramatic: coaching produced a 529% ROI as well as other intangible benefits, and when the financial benefits for employee retention were factored in, the ROI was lifted to 788%.[1] In other words, for every dollar spent on coaching, the organization received $5.29 in direct benefits. That number increased to $7.88 for each dollar spent on coaching when factoring in the financial impact of employee retention.

The Manchester Review published the results of another study[2] that gave very similar results — an average return of 5.7 times the original investment, or an ROI of 570%.

Some of the research conducted to date has focused on what happens when coaching *isn't* done — the loss that comes from the failure to build on investments made in training. A study conducted by Xerox Corporation revealed that without coaching to follow up on training, 87% of the skills-change brought about by the program was eventually lost.

A study by Coaching.com found that coaching also improves the business and personal alignment of people and teams within the organization. Improved alignment has the effect of improving communication and efficiency, making sure that everyone is functioning as a team.

The research supporting coaching is becoming more compelling, so much so that companies that are aware of the research and that have experienced the benefits of leader development conclude that they cannot afford not to fund it.

Another profoundly significant long-term benefit of coaching is an increase in organizational capacity. Fully 93% of people who received coaching in the study conducted by Coaching.com gained coaching skills and were able to coach others within the organization. This allows for a more systematic and deliberate succession planning and development. Leaders need to consider whether their organization has a clear leader development plan that allows for succession and continued company performance over time. In our work at FMI, we see many leaders/owners who realize as they approach retirement that they have no way of maintaining the value of their equity and no means of extracting it

from the company without a talented leadership team in place. Successful exit strategies require talented leaders no matter what approach you take, and that requires coaching.

> **Some of the research conducted to date has focused on what happens when coaching isn't done — the loss that comes from the failure to build on investments made in training.**

THE PROFESSIONAL AND PERSONAL IMPACT OF COACHING ON THE PLAYER

What about the player? The benefits to the individual in terms of productivity and effectiveness, as well as its impact on the individual's sense of self-worth and accomplishment, is dramatic — again, reinforced by some revealing research.

At FMI our observations with thousands of clients have been that working with a coach has enabled leaders to delegate responsibilities and tasks more effectively, build better relationships, and think more strategically about the direction the organization is moving in. In addition, players frequently report improved clarity about their personal goals and plans for achieving those goals. Coaching has enabled many of our clients to increase their awareness of personal strengths and limitations, and develop strategies for leveraging those strengths while compensating for personal limitations. Clients have also improved their skills in communication, goal setting, planning, and stress reduction.

The Manchester Review study mentioned earlier measured the results of 100 players to evaluate the impact of the six to 12-month coaching engagement. They identified many of the same benefits that FMI players report. The tangible business benefits of the coaching that surfaced from the study included the following:

- Increased productivity
- Improved quality
- Increased organizational strength
- Better customer service
- Reduced complaints
- Increased retention rates
- Cost reductions
- Bottom line profitability
- Top line revenue.

The study further identified intangible impacts of coaching:

- Improved relationships with direct reports
- Improved relationships with stakeholders
- Improved teamwork

- Improved relationships with peers
- Improved job satisfaction
- Reduced conflict
- Increased organizational commitment
- Improved relationships with clients.

Each of these benefits impacts the player individually as well as the organization as a whole.

People change because another person invests the time and energy in their life, holding them accountable to reach their potential. It is through this one-on-one investment that the individual is able to reach their full potential. For those who benefit from the full impact of coaching, it can be a life-changing experience with long-term implications personally as well as professionally.

THE PERSONAL BENEFITS OF EXECUTIVE COACHING TO YOU, THE COACH

So what's in it for you? What is best for the company may not be what's best for you. It is a very legitimate question that often does not surface for the obvious reason that the prospective coach does not want to appear disengaged from the corporate direction. Let's review the benefits of being a coach.

Coaching helps you develop the leadership skills needed for the 21st century.

"If you want to be relevant as a leader in the 21st century, you will need coaching in your toolbox," James Belasco said. "Yesterday's leader," he continues, "was a decision maker and a resource allocator who asked how to best exploit an employee's abilities for the organization's gain. Employees were seen as tools and resources for accomplishing the organization's goals. Today's leader is a people developer and relationship builder who asks, 'How can I help this person become more valuable as an individual as well as to all of us?' Today's leader is a coach."

Coaching helps to build your success on a solid foundation.

Many people spend their careers trying to figure out how to become more successful. The answer is to make others more successful. Coaching helps us shift our focus from creating our own success to creating other people's success, and that shift actually enhances our careers. It helps us focus on impact, not on promotion, and when we do, promotion takes care of itself. You become a talent developer, someone who has learned the secret of coaching others in such a way that their talents are brought to their full potential. And that, according to a research report from the Conference Board (*Developing Business Leaders for 2010*), is one of the critical competencies for leaders as we move into this new century.

Coaching keeps you on the cutting edge of growth and learning.

Leaders are learners, and coaching keeps you learning. “If I want to learn something, I teach it,” Ken Blanchard once said. We could just as easily say, “If I want to learn and grow, I coach.” One of the most powerful learning techniques — perhaps the most powerful technique — is helping someone acquire the skills they need, whether or not the coach possesses those skills.

Coaching helps you get your time back.

Although coaching does involve an initial investment of time, the rewards come back in exponential timesaving. Consider how much time it would free up for you, if through your coaching of emerging leaders in your organization, these individuals gained the confidence to take on responsibilities that you currently own. Now imagine those people turning around and developing others. The savings in time are now multiplied, and you are no longer spending your time putting out fires or consumed by problems that grow.

People change because another person invests the time and energy in their life, holding them accountable to do what they need to do to reach their potential.

Coaching helps you become an accomplished talent-spotter.

The mark of a great leader is the ability to identify an individual’s talent and identify those environments where they will flourish. Gallup’s research, described in *First Break All the Rules*, identified this ability as one of the distinguishing characteristics of great leaders. They also recognized that those leaders who could spot talent were more committed to developing that talent. There is an intuitive correlation between coaching and talent-spotting: the more skilled we become at coaching, the better we know what we are looking for and the more easily we can identify it.

Coaching builds your reputation on more than just competence.

In the past, a reputation for getting work done may have been good enough, and it may not have mattered how many people you angered so long as you got the job done. But today’s marketplace is different; getting the job done is still important, but equally important is how you get the job done. Character does matter, and becoming a good coach builds a reputation for character.

Coaching builds a strong network of relationships.

We all know that success depends on whom you know, and by becoming a great coach and a respected developer of leaders, you gain the support and respect not only of an organization grateful for your investment in its future, but also from the people you have developed and in whose lives you have invested. Loyalty is hard

to come by these days, but a great way to earn loyalty is to develop your coaching skills.

Character does matter, and becoming a good coach builds a reputation for character.

Coaching connects you to your company's competitive edge.

Even if your company is not committed to raising up the next generation of leaders, your focus on coaching and leader development represents an opportunity to deeply impact the direction of your company. You will be contributing to the one key factor that more than any other will shape the future of the company — the quality and caliber of its future leaders. Every project you are engaged in, every building you build, every street you pave, every cubic foot of concrete you pour, is not just another notch on your hard hat — it is an opportunity to develop someone who, guided by your coaching, could become a builder of the company's future greatness.

Coaching helps you avoid derailment.

One of the unfortunate realities we encounter in leaders is the tendency of people to stop growing and learning, usually somewhere in their 40s. At that point, many leaders tend to rely on what they already know, and the blind spots they haven't addressed typically become derailment issues. Coaching keeps leaders sharp because it keeps them learning; it keeps them from settling back into the comfort of their own entrenched assumptions, and by the same token, it helps them confront their blind spots. You are less likely to get derailed in your career because coaching helps you stay fresh, receptive, and connected.

Coaching provides a deep sense of accomplishment.

Chances are that you got to where you are today with the help of others. Coaching your employees to reach their potential can provide a deep sense of accomplishment. Seeing the person you are coaching reach a milestone in their personal or professional life due to the investment you have made in them can be a life-changing experience for you. What are you doing today to impact the lives of people around you and the success of your organization?

So why should you coach? What's in it for you? Plenty! Enduring success based on what really counts: a deep sense of fulfillment and contribution; a strong legacy and a lasting impact; a solid reputation among your leaders, peers, and direct reports; and a lasting network of friends.

Loyalty is hard to come by these days, but a great way to earn loyalty is to develop your coaching skills.

WHY LEADERS AREN'T COACHING EMPLOYEES

You would think that with such compelling arguments, leaders would be jumping at the opportunity of not only bringing coaching into their organizations but also developing their own coaching skills. The reality is that they aren't, and it highlights the hurdles we face in making coaching part of our daily corporate existence. A study of U.S. and European companies conducted by the Conference Board of New York found that poor or insufficient job-performance feedback (a critical part of coaching) was the leading cause of individual employee performance problems in 60% of the companies surveyed. In a separate study of 1,149 people at 79 companies conducted by Development Dimensions International, a Pittsburgh-based consulting firm, managers' feedback and coaching skills were rated as only mediocre.

So what are the obstacles leaders face in coaching? Given the growing interest in coaching, a number of studies have been addressing those obstacles. A recent article in *Training*[3] sites several of these studies, and the main obstacles boil down to a few common mental barriers:

Reluctance to confront direct reports

When leaders think of coaching, their minds are filled with vivid and painful images of annual performance reviews. But such thinking misunderstands the nature of coaching. It's not just about performance shortfalls; it's much more about performance enhancement. It also underestimates the desire of the player to be coached. Most people would welcome the opportunity to have someone involved in their development.

Reluctance to approach an employee who has more expertise than the leader in a particular area

If you have an individual highly gifted and competent in a certain specialty area, you may feel that you have nothing to teach them. Again, this is a misunderstanding of coaching. The coach doesn't have to be the expert — just the person who facilitates, encourages, and stimulates growth and learning.

Fear of offending the player

Sometimes leaders fear offending the player by talking about the need for development in order to move forward in the company. If you explain that by offering to act as a coach you are willing to work with them, you will create a sense of partnership and avoid the risk of offense. You must have faith in their ability to improve — or you wouldn't be offering to coach them.

Fear of failure

You may be thinking that you have been successful thus far in your career without coaching, and the idea of trying something new is daunting. You may be reluctant to move out of a comfortable approach that has worked for you in the past. First, it may have worked in the past, but as you move forward, it's unlikely to continue to work; you need to learn this for the sake of your career. And second, yes, you will make mistakes and yes, at first it will be uncomfortable. The process of learning to be an effective coach is a journey. But making the effort to coach and gaining experience in coaching your employees will take you in the direction you want to go as a leader. Your fears will subside as you gain experience with coaching — and before long, you will be a supporter of coaching.

Lack of role modeling and personal experience in coaching

One reason that you may lack coaching skills is that you have never experienced the benefits of formal coaching in your own development as a leader. You may even be in an organization that fails to support coaching efforts, or worse still, unconsciously militates against it through performance or incentive systems that breed competition rather than cooperation. In such a setting, shifting your focus from what you need to do to get ahead personally to what you need to do to bring the company ahead (develop the next generation of leaders) will require a shift in thinking by the leadership of the organization. But in the meantime, you can make your own personal commitment to coaching.

Lack of time

This is perhaps the most often-cited reason for leaders not investing in coaching. As you can see from the benefits of coaching, you don't have the time not to coach your employees. Helping your employees develop critical decision-making and leadership skills will ultimately create much more time than it will require.

Helping your employees develop critical decision-making and leadership skills will ultimately create much more time than it will require.

Not knowing where to begin

By this point, you may have bought into the arguments for coaching and you may have already embraced its benefits for you, for the person you are coaching, and for your organization. But maybe you're unsure where to start. Here are a couple of tips to get you going. First, become a student of coaching. Start reading about coaching. Talk it up in your company, and ask your colleagues what they do to coach. Ask your boss. Attend some classes on coaching. Look for models on coaching. Second, become a student of your direct reports. Start asking your direct reports

what they want to learn. Ask them their career aspirations and together start a dialog about how to get there. Observe them, and look for ways their strengths could be enhanced. If you get the ball rolling, you'll be amazed at the speed it picks up.

Coaching is corporate America's best-kept secret. Coaching can have an unparalleled impact on your organization, on the people you are coaching, and on you as a leader and coach. It will transform the way you lead and the way your organization creates leaders. As a return on investment, it is pretty hard to beat, and it all begins with you. ■

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How's Business?

Contractors answering "great" to this polite social question almost always maintain a constant focus on the marketing of their business.

By Stuart M. Deibel

Three different contractors answer this question, and each contractor's answer reveals a different strategy for success. The first contractor invested the time and resources into developing a niche market. The second contractor focused on customer relationship management to ensure a sizable backlog. A third contractor found that if you're not diligent with your clients, they may welcome advances from other contractors. Together, these three stories illustrate the need to pay attention to your business, *all the time.*

When most contractors are asked, "How's business?" they usually either say "fine" or "terrible." When you ask probing, follow-up questions, though, you can learn what the contractor is doing to create or maintain a best-of-class contracting firm.

Here are three, distinct responses. But the one theme running through their answers is a constant focus on marketing. Keep your typical answer in mind as you read what your competitors are doing to be successful in the ever-changing construction industry.

CONTRACTOR A

The year 2003 will go down as the best business year we've had in 48 years. In

fact, we're not even worried about the next three years. We have so much business in our backlog that we're looking for strong talent to help complete this work profitably. We really have a sufficient workforce in place to do the work, but we figure by hiring good people while other companies are laying off people, we'll be able to generate even more work.

I was surprised to hear this contractor say business was thriving in an economic environment in which many companies are barely surviving. The contractor went on to explain about niche marketing. The company invested the time, energy, and money several years ago to see what changes or direction they needed to take with the company. They wanted to make sure the company was sustainable, so they found out what they were good at, what made them money, and most importantly — what they enjoyed doing. The answer was industrial piping and that became their niche market and focus.

At this point, the company invested all its efforts into learning everything about the industrial piping market. They invested time in local and national associations and organizations that put them in touch with what was happening in their markets. They had a good history with some clients, but knew they had to be the company that came to mind for all industrial piping work in their market. They got to know their clients and prospects. They became known, internally and externally, for their industrial expertise.

Exhibit 1

Ten Important Questions to Ask When Trying to Learn More about Your Market and the Clients in Your Market Who are Buying Construction Services

1. Tell me about your general experiences with contractors on previous capital projects?
2. Are you working with a select group of contractors?
3. What characterizes good (minimum acceptable) contractor performance on your jobs?
4. What went well?
5. How are you going to monitor performance on future projects?
6. What unique expertise will be required on your future projects?
7. Describe the decision-making process on a couple of your most recent capital projects?
8. What is your greatest dissatisfaction or biggest point of pain with engineers/designers/contractors?
9. Do you anticipate outsourcing more engineering/design/maintenance work in the future? Why, or why not?
10. Are you considering different ways to structure contracts or deliver projects in the future (for example, more design/build, more negotiating, fewer "select-list" contractors, etc.)?

This seems so easy, almost too easy. It worked for them. While competitors pursued more "glamorous" work, contractor A stayed focused on what's most important — keeping the customer happy.

CONTRACTOR B

We enjoyed tremendous success in the 1990s. We've been in business since the 1940s, so we have lots of experience. We have a niche market; we do nothing but air conditioning. We started finishing jobs in 2001 and 2002 and realized that suddenly we didn't have any new work. We had forgotten how to sell. We assumed all our good work would continue to generate more work and we just focused on the "do work"

Exhibit 2

Ten Benefits of Strategic Planning that Lead to Sustained Competitive Advantage
1. A unified direction for your company
2. More effective communication, especially among the planning team participants
3. More effective communication with employees, customers, and creditors
4. Better anticipation of changing conditions
5. Heightened sense of order and discipline
6. Improved skills in group problem-solving and decision-making techniques
7. Improved leadership and management skills for the participants
8. Enhanced teamwork
9. Strengthened sense of commitment
10. Greater focus for the efforts of key managers

part of the business.

We had been extremely good at the "get work" part for so many years. The 1990s made us look very smart. It was easy to assume we'd continue to get this volume of work, or more if we wanted. Then, we lost money for the first time. The year 2002 was a wake-up year.

We didn't have any bad jobs. But we just finished a large number of jobs in that year, and we'd neglected the "get work" phase. It wasn't that we'd changed, the market

Exhibit 3

Exhibit 4
Various Results of Increased Productivity

	Normal	% of Sales	Decrease Labor Cost by 10%	% of Sales	Increase Sales by 39%	% of Sales
Sales Price	$3,000,000	100.00	$3,000,000	100.00	$4,193,181	100.00
Direct Cost						
Material & Subcontracts	$1,275,000	42.50	$1,275,000	42.50	$1,782,102	42.50
Labor (Taxes & Insurance)	1,050,000	35.00	945,000	31.50	1,467,613	35.00
Other Direct Costs	261,000	8.70	261,000	8.70	364,807	8.70
Total Direct Cost	$2,586,000	86.20	$2,481,000	82.70	$3,614,522	86.20
Gross Profit	**$414,000**	**13.80**	**$519,000**	**17.30**	**$578,659**	**13.80**
Operating Expenses						
Variable Overhead	$150,000	5.00	$150,000	5.00	$209,659	5.00
Fixed Overhead	223,200	7.44	223,200	7.44	223,200	5.30
Total Operating Expenses	$373,000	12.44	$373,200	12.44	$432,859	10.30
Net Profit	**$40,800**	**1.36**	**$145,800**	**4.86**	**$145,800**	**3.50**
% Increase in Net Profit			**265%**		**265%**	

changed. We needed to do something fast. We gathered the team and thought strategically about how we were going to rebuild our backlog. We looked at our best clients, our best people, and our most profitable type of work and assigned people to do what we used to do, but had gotten away from.

We focused our attention on getting the right people in our organization to talk to the right people who could give us work. We created a plan for success. We didn't start randomly slashing our overhead, but we did look closely at our major expenses.

The chart above shows the results of increased productivity vs. an increase in sales. The numbers show that net profit is improved 265% with a 10% improvement in labor cost. It takes a corresponding increase in sales of 39% to equal the same net profit improvement in our case. Consider this evidence when you're slashing overhead.

The results have been fantastic. We currently have the biggest backlog we have ever experienced in our history, and we are starting to work on this backlog with a renewed sense of purpose. We're also measuring our progress and keeping an eye on the amount of backlog.

We are once again focusing on the "do work" phase. We want to do it profitably as well. We're equipping and incentivizing our field managers. We want to make sure that our clients are happy with us and that our employees are happy with us as well. Without our people, we could never do this successfully.

As leaders, we need to be creative; we need to encourage our people to constantly look for ways to improve the company, and to find more work.

CONTRACTOR C

I'll tell you how business is, we lost our best customer to our worst competitor!

Imagine going through your business life with rose-colored glasses, thinking everything is fine. What a surprise when you take them off and you realize something happened.

As a contractor specializing in building offices for non-profit organizations, I pride myself on doing a great job for my clients. Imagine my surprise when I got a call to meet with the board of directors for a client who I've worked with on three major projects. When I arrived, I saw my competitors.

I was shocked. Why were they there? How did they get invited? What did I miss? Had I taken my best client for granted? When was the last time I, or anyone on my senior management team, thanked our client for their business?

I didn't like this. I started sweating. I realized that I hadn't prepared properly. I had just brought my regular, run-of-the-mill material for the presentation and suddenly I knew that I might be in trouble. I also realized that the owner's group was represented by more people than I'd ever met. My good friend, the owner, had a team with him, a board of directors, and I knew things had changed. I gave my presentation; the group thanked me for coming and said they would call me.

The job was a women's club office building in my hometown, less than a mile from my office. It was a perfect job for my company, and one that I had already budgeted in my revenue projections for the year. Even though I was nervous with my competitors in the room, I still just knew I'd get the job.

By now I bet you can guess the outcome of my presentation. We didn't get the project. I couldn't believe it. What had happened? How could one of my weakest competitors steal a perfect job from my company?

It took some time to find the answers, but I did. No. 1, the board was not impressed with the lack of teamwork during my presentation. They counted the number of times I used "I." They pride themselves on teamwork in their organization, and they even emphasize it on their web site, in big, BOLD, letters. I didn't look at their web site when I prepared for the presentation; I didn't think I really needed to prepare anything special. I thought I knew what they wanted, a good building built according to plans and specifications. What did the winning competitor do? They had a team of men and women on their presentation team. Each member highlighted how their strengths support the team and what this means to the clients. They painted a construction process that had the client in the middle with everyone on the team working to please the client.

I thought it was about building a building, but it's not. Almost anyone can build a building. It's truly about making the client happy while delivering a product and a process that the client enjoys.

When you've lost to a competitor, what do you do? Cutting your price is always one option, but not usually your best option. Better marketing and better selling are other processes that help you win. Assume that your competitors are not standing still. Assume they are looking for every way possible to take business from you. You must constantly be looking everywhere for an edge. Work on your existing clients first. Do everything you can to keep them. It's much more expensive to find and get new clients.

So the question is: How's business? How are you going to answer? You can say "fine." You can say "terrible." If you pay attention to your business, all the time, your answer of "fine" will be accurate most of the time. ■

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Your Human Resource Investments

With two-thirds of an organization's money being spent on its people, measuring human resource investments is critical. Find the link between the investment and the bottom line, and then evaluate the true impact of the investment.

By Jim Krug & Renee Snyder

Henry Ford once made the comment that what he really wanted was just a pair of hands, and instead he got a whole body attached with it. Many construction project managers and foremen have probably encountered days when they wished for just a part, and not the whole person.

Dealing with people and their motivations can be complicated and frustrating. How many times have you heard a construction executive say, "Our people are our most important asset," only to discover that the organization actually does little to increase the value of that precious resource or has no measuring stick for evaluating their human resource investments. Too many times the organization has little relevant data on its turnover costs, return on investment for training and professional development, or how its compensation and benefits plans compare with the competition.

People are not only an organization's most important asset — they are also the most expensive one. The typical organization spends over two-thirds of its money on its people. Auditing these expenses may seem relatively easy; however, much of the data that is typically collected tends not to be very useful for two reasons. First, the data often focuses merely on activity counts such as the number of training programs conducted or the number of new hires per year, and not on how these activities create business impact. Second, the data often provides only historical information and does not offer predictive information that the firm's management can use in making strategic business decisions for the future.

As a result, dramatic changes in how human resource investments get measured are urgently needed. In order to effectively measure and evaluate human resource investments, the firm's management team needs to understand how human resource practices can contribute to business success. Only then, can the firm determine which people investments will add the most business value.

> The need to evaluate human resource activities in economic terms is becoming increasingly apparent.

How does a firm know if its human resource practices have an impact on its business results? Where on the balance sheet can you find the company's return on investments in its people? Most companies complete an extensive audit of their financial statements on an annual basis, but the human resource investments involved in developing the quality of the firm's people (recruiting, training, pay for performance, etc.) are seldom given the same scrutiny. The need to evaluate human resource activities in economic terms is becoming increasingly apparent. In the current climate of rising costs for labor, energy, and raw materials, operating executives justifiably demand estimates of the expected costs and benefits of human resources. Developing such measures requires an interdisciplinary approach that incorporates information from accounting, finance, economics, and behavioral science.

FINDING THE RIGHT MEASURES

The design and development of human resource measurements should be focused on the answers to the following set of questions:

How does the firm compete in the marketplace?

Reviewing the firm's business strategy and what is required for the firm to succeed in the marketplace is an important first step in developing human resource measures. To achieve success, a firm must find its own niche in the market and determine how it will distinguish itself from its competitors.

What is it that sets your firm apart from competitors?

Is it a high level of expertise in a specialty area, outstanding customer service, the ability to be a low cost provider, or something else? Perhaps, you are fortunate enough to be the only provider of your kind in your geographical area. However, what if that were to change, then how will you compete? What unique offering does your firm bring to the marketplace?

A clear understanding of the firm's strategy is essential in designing human resource measures because human resource investments must be aligned with strategy in order to obtain maximum benefit from them. For instance, a firm may spend extensive time and expense on customer service training only to discover it provides a very small return on investment because the majority of clients who purchase the

firm's services do so strictly on the basis of price. While enhancing the firm's level of customer service is a noble goal, the return on investment may be minimal at best for a firm that competes by being a low cost provider because this training is not aligned with the firm's strategy. As this example illustrates, a "one size fits all" approach to human resources is not effective because the value lies in the firm's ability to align its people with its business strategy. This concept leads to the next important question to ask yourself when developing human resource measures.

How can people create a sustainable competitive advantage for the firm?

A great plan or business strategy alone does not ensure success. It must be executed well for the profits to flow, and successful execution lies in the hands of the firm's people. Taking your business strategy into consideration, you need to determine what it is that you need from your people to make it happen. For instance, for a low cost provider, having employees that are cost conscious, somewhat risk averse, resourceful, and that do more with less goes a long way toward helping the firm ensure that profit margins are not eroded away. In contrast, a firm that is known for its innovative practices will need to invest funds in new ideas and training in new techniques to maintain its competitive edge. A firm's people need to understand the firm's strategy and engage in behaviors that support this strategy. Investing in the "human" side of the business should be geared toward promoting employee behaviors that support the business strategy, as this provides the greatest long-term payoffs. Ask yourself, "How can your people help the firm leverage its place in the market?" In addition, "What investments can the firm make to provide its people with the tools and incentives required for them to enhance the success of the firm?"

Where is the link between the human resource investment and the firm's bottom line?

In determining which human resource investments are the "right" investments, the key lies in uncovering the link between the investment and the impact it will have on the firm's bottom line. For instance, if you are a specialty contractor, you likely depend upon the high level of expertise of those in your company. Therefore, keeping these talented employees within the company is of paramount importance. The critical link between the company's bottom line and the human resource practices in this example lies in examining what the company is doing to retain these critical employees. As a result, opportunities for development, reward/recognition programs, and compensation/benefits packages could all be found to have a direct link to the company's bottom line. These activities directly support the firm's ability to keep its people, who are critical to its success; therefore these

A great plan or business strategy alone does not ensure success. It must be executed well for the profits to flow and successful execution lies in the hands of the firm's people.

efforts will have a high return on investment for the company. Measuring the link between the people investment and what it does to help the firm attain its business goals is the essence of human resource measurements. If no clear link between an investment and the bottom line can be found, the value of the investment should be called into serious question.

SAMPLE MEASURES

To begin thinking about how human resource measures could be instituted to add value to your company, consider the following list of measures. Remember that a "one size fits all" approach cannot be used in selecting human resources measurements. Use the list below to evaluate if these measures as well as other measures would be valuable to your organization. Beware of simply measuring activities; keep your focus largely on factors contributing to business success.

Staffing

- Acceptance per offer ratio
- Time and cost of filling a job
- Percent of internally vs. externally filled jobs
- Employee turnover measured in terms of performance level and controllability
- Average tenure with the company among employees
- Average age of the workforce; management succession plan in place

Training and Development

- Percentage of employees with development plans
- Planned development opportunities accomplished
- Percent of employees involved in training
- Percent of training dollars to payroll dollars
- Comparison of training evaluations two to six months after courses are completed vs. at the end of a class
- Number and type of "special projects" to develop high-potential employees

Performance Appraisal Systems

- Percent of employees receiving performance appraisals
- Effectiveness of appraisal process for dealing with poor performers
- Percent of total salary at risk
- Labor costs per revenue dollars
- Levels of salary compared to competitor's salary levels

Rewards

- Average salary increase granted by classification
- Incentive compensation differential (low vs. high performers)
- Number of spot bonuses awarded and individuals recognized in the past fiscal year for outstanding performance
- Number of non-financial reward systems in place and utilized by management

Culture

- Level of employee satisfaction with the policies and practices (employee surveys)

- Extent to which the workforce is clear about the firm's competitive strategy, mission, vision, values, and operational goals
- Extent to which the firm is helping to develop necessary leadership competencies
- Extent of organizational learning

Communication

- Frequency and effectiveness of information sharing among departments
- Percent of employees making improvement suggestions and percent of accepted suggestions implemented
- Consistency and clarity of messages from top to bottom

The ability of a firm to effectively measure its human resource investments is powerful. When the right measures are selected, they provide the firm with valuable information about its performance and what adjustments may need to be made in the future to execute its strategy. When human resource investments are measured correctly, the information gathered can be extremely helpful in future decision-making. Furthermore, human resource measures are a great tool for communicating what is important to all members of the organization. There is an old adage, "What is measured, matters." The measures a firm selects to track send a strong signal to employees about what behaviors are valued by the organization. When employees know what measures are being tracked, they are much more likely to engage in the behaviors associated with turning out good numbers for these measures. If what is measured is aligned with what it takes for the organization to execute its strategy, the entire organization will be making strides in the right direction. Used in this way, human resource measures can provide a great way to identify and reinforce key behaviors among employees that are critical to the organization's success.

The ability of a firm to effectively measure its human resource investments is powerful.

In selecting human resource measures, the guidelines provided in this article can serve as a valuable tool. By using the simple set of questions provided above to identify the important human resource measures in your organization, you can begin to track the measures that will have a great impact on the overall success of your organization. With two-thirds of a typical organization's money being spent on its people, measuring the value of human resource investments is very important. The next time you are looking to measure the success of a human resource investment, don't settle for tallying the number of training hours completed. Take the time to work through the process of finding the link between the human resource investment and the firm's bottom line, then you can evaluate the true impact of the investment. ■

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Selling Out an ESOP

Is an ESOP the right retirement investment vehicle for your employees — even a partial one?

By Tony Perrone, Ben Brahinsky, & Randy Stutzman

There are a number of ways to sell all or a part of the ownership of a company. An outright sale to a third party, whether it is an industry participant or a financial buyer, is the most direct method used in the construction industry when an owner wants out. If an owner wants to keep the company in the family and/or employees' hands, or it is not likely to be sold to a third party, then an internal transition plan is needed.

In its *Ownership Transfer/Management Succession* consulting practice, FMI evaluates numerous methods for clients to consider in transitioning ownership. The use of any one plan depends on the circumstances of the business and the objectives of the owners and principals involved. The Employee Stock Ownership Plan or ESOP is one technique that has not been utilized by many construction industry firms before now, but it is gaining acceptance due to recent changes in the tax law.

The concept of ESOPs has been in existence for more than 50 years as an alternative retirement vehicle for employees and their companies, but more importantly, as a way of promoting employee ownership. Proponents of the ESOP technique suggest that when employees become owners, it is to their benefit to help the company and its stock grow in value, making the employees both more motivated and productive — or so the altruistic premise went. However, the use of

prior forms was very limited and not taken seriously in the business world until Congress passed the Employee Retirement Income Security Act ("ERISA") in 1974. This act provided significant positive tax attributes for ESOP companies. While the jury is still out on whether ESOPs have met their altruistic objectives, evidence as to the economic advantages of this ownership technique — especially as a way to buy out original owners — has been more compelling. Several new laws have been passed since ERISA, each of which has enhanced the benefits and appeal of ESOPs, including the most recently passed Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

Since their introduction by Congress, approximately 11,500 ESOPs have been installed in the United States, which now covers more than 8.5 million employees. Interestingly, recent data published by the ESOP Association indicates that there are less than 250 ESOP organizations in the engineering and construction industry (architecture, engineering, and environmental firms; contractors; and construction materials producers), accounting for less than 3% of all ESOP companies.

Why have ESOPs not been popular with construction firms before now? We believe there may be several reasons. Most construction companies were started by and are still owned by a few entrepreneurial individuals who like to keep decision-making and the subsequent risks and rewards to themselves. Spreading out ownership and decision-making to the masses is not compatible with the philosophy of the typical construction company owner. Furthermore, an ESOP is intended to provide a retirement fund for employees. Yet, with most of the investment of the ESOP in company stock, employees' retirement is dependent on the future success of the company. Construction is a highly competitive, highly cyclical business, with many players exiting the market regularly for reasons both in and out of their control. The industry would not seem to be a safe place to put one's retirement investment. From both management and economic standpoints, this is why FMI generally does not recommend ESOPs for most of its construction industry clients.

The concept of ESOPs has been in existence for more than 50 years as an alternative retirement vehicle for employees and their companies, but more importantly, as a way of promoting employee ownership.

However, there may be exceptions. Those construction businesses that have large non-union and more homogeneous workforces (although unions can be invited to be ESOP members); are not dependent on new construction; do not perform bonded work; have a meaningful service or renovation component in their business mix; and have growing, but stable earnings are potential candidates for an ESOP structure. Unfortunately, most contracting companies do not have these characteristics. But some do, especially

the larger non-unionized specialty contractors in electrical, mechanical, and interiors construction services. Architectural and engineering firms with more than 100 employees can also make good ESOP candidates. Broad-based employee ownership fits with the culture and makeup of many design firms. AECOM and Parsons are examples of well-known, successful ESOP-owned A/E firms.

Exhibit 1

$50 million Nonunion Electrical Contractor
Sale to Leveraged ESOP S-Corporation vs. Third-Party Acquiror

	Sale of Stock to	
Effect on Original Owner	ESOP & Convert to S-Corp[1] $ Thousands	Third-Party Acquiror $ Thousands
Selling Price for 100% of Stock	10,000.0	10,000.0
Owner's Tax Basis in Stock	0	0
Sale of 10% to Two Key Employees	1,000.0	-
Sale of 90% to New ESOP	9,000.0	-
Total Pretax Sale Price	10,000.0	10,000.0
Pretax Capital Gain on Sale[2]	[2] 1,000.0	10,000.0
Capital Gains Tax on Sale	(200.0)	(2,000.0)
After-Tax Proceeds	**9,800.0**	8,000.0
Advantage to Owner	**1,800.0**	
Effect on Company After the Sale		
Operating Earnings (Pretax Earnings)	2,500.0	2,500.0
Tax or Cash to Pay Taxes of Owners[3]	[3] 87.5	875.0
Effective Tax Cash Savings to Company	**787.5**	

1 Company is a C-corporation that converts to an S-corp. just after the stock sale to the ESOP.
2 Owner reinvests $9,000,000 from ESOP in stocks and bonds and gets 1042 Rollover for deferral of gain.
3 At 35% income tax rate, to be distributed only to 10% owner/managers of ESOP S-corp; 3rd-party acquiror pays taxes on 100% of pretax earnings.

There are a number of other factors beyond the scope of this article that should be considered before implementing an ESOP for your company. A company may be a good ESOP candidate; however, how can an ESOP be used to buy out some or all of your ownership in the firm, and what are the economic advantages of doing so? The "leveraged ESOP" is the vehicle. If your company is a regular or C-corporation, the leveraged ESOP, combined with converting to a subchapter-S or S-corporation, is the way to go. Under the 2001 Tax Act, there are also new, fairly complex rules relating to prohibited transactions with "disqualified persons," which were instituted by Congress to prevent abuses in converting from a C- to an S-corporation ESOP. Given that these provisions do not apply in this case, the following example (see Exhibit 1) illustrates the economic basics of the conversion.

Let's say the company is a $50 million electrical contractor with an eligible total workforce of 500 people (including nonunion craft workers) and a payroll of $25 million for this group. The company is in good, growing markets, and generates almost all of its revenue from annual service contracts with its customers. The company's clients include commercial, industrial, and residential accounts, and most of the company's work does not require bonding. The company has regularly been

generating \$2.5 million (5%) of operating earnings (earnings before interest and taxes or "EBIT") and \$3.0 million (6%) in operating cash low (earnings before interest, taxes, depreciation, and amortization or "EBITDA"). The company has been contributing 5% of payroll to a 401(k) plan for its employees. The company has no interest-bearing debt on the balance sheet and a book value of \$8 million. It is a C-corporation of which you are the sole owner.

Spreading out ownership and decision-making to the masses is not compatible with the philosophy of the typical construction company owner.

For illustration purposes, let us assume that the stock is worth \$10 million (4 x \$2.5M) on a fair market value basis. You are 60 years old, have no family successors, and do not want to sell the company to third parties. You want your trusted employees to be the new owners.

You decide your company has the right characteristics to use a leveraged ESOP to effect a sale. The transaction proceeds as follows. An ESOP and its trust ("ESOT" or "ESOP" are being used interchangeably here) are established for the benefit of the 500 eligible employees. You are a trustee of the ESOT along with two of your key employees, who are the successors to run the company. You also bring in an outsider as an independent trustee (typically a banker or lawyer) for fiduciary oversight. (To make sure employees are treated fairly, ESOPs are under the purview of not one, but two government agencies: the IRS and the U.S. Department of Labor).

You sell a small portion of your stock to the two managers up-front, e.g., 10% for a \$1,000,000, five-year note. Once the ESOP and ESOT are in place, a bank, insurance company, or other financial institution is brought in to handle the financing of the rest of the stock sale. The bank advances \$9,000,000 through a note to the ESOT, with repayments guaranteed by the company to secure the financing. The note has a six-year term with principal payments of \$1,500,000 per year plus interest at a 7% annual rate. You sell the rest of your stock to the ESOT for the \$9,000,000 in cash. Shortly after the sale, the company converts from a C to an S-corporation, of which the ESOT is now a 90% stockholder. Under tax laws enacted in 1996 and 1997 and expanded by EGTRRA in 2001, ESOTs are one of the few qualified trusts that can be

owners of S-corporations. Regardless of the amount of shares owned and the number of employee participants in the ESOP, the ESOT itself is considered a single stockholder for purposes of the maximum 75 individuals that are allowed to be owners of S-corporations.

For the sale of 10% of the stock to your two key employees, you will pay a capital gains tax on the difference between your prorated basis and the $1,000,000 sale price, spread out on an installment sale basis over the five-year term of the notes. The tax aspects of the ESOP transaction are a lot more extraordinary and fascinating. Because the company was a C-corporation when you sold the balance of the stock to the ESOT, you can defer the capital gain on the $9,000,000 sale price. The rules say the ESOT must own at least 30% of the stock for the seller to qualify, which you clearly meet here by selling 90%. To get the tax deferral treatment, you must then invest the proceeds within twelve months of the sale in stocks and bonds of public or private U.S. operating companies. The deferral lasts as long as you hold these investments and can continue until you gift or leave them to family members or charities upon your death. This overall provision is known as the "1042 Rollover."

From the company and the ESOP standpoint, the $9,000,000 note to finance the stock acquisition is paid off from contributions the company makes to the ESOP. Actually, the company can contribute up to 25% of covered payroll to its ESOP to finance the principal portion of a note. Interest on the note is not included in the 25% limitation for C-corporations, but is for S-corporations. If the company wants to continue its 5% contribution to the 401(k) plan, it can, and the 20% remainder can be used to service the principal portion of the note. Assuming covered payroll continues at the $25,000,000 level, the ESOP and the company technically can contribute up to $5,000,000 per year (20% of $25,000,000) to pay down the $9,000,000 note balance over its six-year term. However, only $1,500,000 annually is needed by the note terms for principal repayments. In addition, interest payments at 7% will be made on the remaining balance, or $630,000 the first year in this case, then declining over the life of the loan.

The special feature of the ESOP loan, however, is that both interest and principal payments can be deducted from the company's income statement for taxable income computation purposes.

The special feature of the ESOP loan, however, is that both interest and principal payments can be deducted from the company's income statement for taxable income computation purposes. This contrasts with conventional corporate borrowing where only the interest portion of the debt service is tax deductible. Effectively, Uncle Sam is repaying 35% of the loan in a leveraged ESOP for a C-corporation, and more for an S-corporation as

discussed below. This is more important to an S-corporation ESOP when stock is also held by other shareholders besides the ESOT. These stockholders have to report their share of company earnings on their individual tax returns and pay income taxes accordingly.

Finally, there is one additional unique and valuable economic benefit that results from this transaction under the new laws for S-corporation ESOPs. Since the company has been converted to an S-corporation after the sale, the ESOT does not pay income taxes on its share (90%) of the company's taxable earnings. The ESOT is a qualified, tax-exempt trust under the law. Normally, most S-corporations, which are pass-through entities for income tax purposes, distribute at least enough cash to their owners to pay their share of taxes of the company's earnings reported on their individual tax returns. Distributions of 35% to 40% of the net earnings of an S-corporation are not unusual for this purpose. For your electrical contractor, the company's cash flow (EBITDA) after ESOP debt service would be $870,000 the first year ($3,000,000 – $1,500,000 – $630,000) and increasing for the next six years assuming earnings stayed the same. If the company would normally distribute 35% of earnings for the taxes of its owners, it would save approximately $788,000 in cash each year because of the 90% ownership interest of the ESOT (0.9 x 2,500,000 (EBIT) x 0.35) if EBIT just stayed at the $2,500,000 annual level. This additional cash can be used to accelerate the payment of the ESOP note with a dividend, buy new equipment, fund the company's expansion, or pay higher bonuses. This tax benefit continues as long as the ESOP owns the company. Can the tax holiday go on forever? No, as we all know taxes always have to be paid. When employees retire or leave the company and their share of the value of the business is then distributed, they have to pay taxes as ordinary income upon such distributions.

Is the culture of your firm compatible with being run, even indirectly, by 500 employee/stockholders instead of one?

Exhibit A compares the financial impact between selling to an ESOP vs. selling to a third party that the original owner or company might expect.

Nevertheless, does this sound too good to be true? It's really not. Although the example is a simplified and somewhat extreme illustration, the economic effects are fundamentally correct. A more likely scenario, if the company fits most of the other characteristics noted above, is to have the original owners sell their interests over time rather than up-front as in this example. However, the timing to convert to an S-corporation has to be considered so as not

to lose the 1042 rollover tax deferral. Care also has to be taken so that the disqualified persons rules do not take effect, which can disrupt the entire process.

However, as noted above, there are many pitfalls to a leveraged ESOP that need to be considered before deciding whether it is the right course for your construction company. Is the culture of your firm compatible with being run, even indirectly, by 500 employee/stockholders instead of one? Is your company ready for all the new legal, fiduciary, and administrative directives when ESOP owned? Are your earnings and cash flows predictable and stable enough to service ESOP debt? What happens in the inevitable recession? Does your work require bonding? (Most bonding companies do not like leveraged ESOPs because financial reporting book equity can be minimal or negative from the ESOP debt for the first few years.) Do you regularly use bank financing for working capital? Will the company and the ESOT have sufficient cash to make the stock repurchases in later years when senior employees retire?

Is an ESOP the right retirement investment vehicle for your employees — even a partial one? Would they be better off with higher bonuses and/or maximum contributions to their 401(k) plans without any investment in company stock? Would you, the company, and the employees be better off selling to just a few key employees? Why isn't an outright sale to third parties not really the best course for all concerned? These are only some of the issues to consider. Most construction companies do not have the right combination of financial, organizational, and cultural characteristics to make them suitable candidates for an ESOP. Make sure you examine all of yours before you decide that a leveraged ESOP is the right choice. ■

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A Moldy Business

Mold is going to be a problem for the construction industry for at least the next few years. Developers, contractors, suppliers, and insurers and sureties will have to take aggressive steps to reduce and manage their risks to survive in the marketplace.

By Susan McGreevy

Mold is the fastest growing risk-management problem in the U.S. Tenants, lenders, contractors, building owners, and homeowners have a potential loss exposure to mold damage. Mold will affect more insurance buyers than asbestos.

This statement appropriately emphasizes the gravity of the problem mold is causing in the construction industry. Even if (as most in the industry agree) the actual potential damage is not significant, as long as the perception persists that it is toxic, there will be a risk management issue to be dealt with. This article provides an overview of the problems created by mold in construction and the related insurance and surety markets; the specific effects of mold on insurance and surety bonds; and the options available to the construction industry to reduce and spread the risk associated with the mold problem.

MOLD IS NOT NEW TO CONSTRUCTION

Water is the source of more damage to structures than any other cause. Contractors, their vendors, and their sureties and insurers, have dealt adequately with the risks associated with moisture for a long time. What has changed is the recent spate of large jury verdicts for personal injuries attributed to mold exposure. Insurers have reacted by taking strong action to limit their future exposure, and contractors and designers have had to learn about where mold comes from, and how to avoid it in construction in order to minimize their exposure.

HOW MOLD GETS INTO BUILDINGS

Fungus is everywhere. All that it needs to grow is warmth, moisture, and food. Since many construction materials are cellulose (wood or plant) based, and most structures are temperature controlled, these factors really can't be avoided. What sets mold on its explosion course is moisture. Large amounts of moisture can be introduced into a building by several causes, including improper design, construction, or maintenance of the building's exterior envelope or its air handling system. Failure to control the building's "envelope" — its roof, walls, and foundation — is the usual source of moisture that is essential to the growth of mold. Water may penetrate from above and laterally (wind-driven), and ground or subsurface water can enter through a building foundation.

Fungus is everywhere. All that it needs to grow is warmth, moisture, and food.

Water may accumulate in and spread through an improperly designed or installed heating, ventilating, and air conditioning ("HVAC") system. The fans, humidification, and/or de-humidification equipment in those systems control not only the temperature, but also the humidity, or moisture level, of air in virtually all buildings. Changes in temperature and pressure brought on by the operation of the HVAC system or the failure to operate the system may lead to condensation and provide a continuous source of water for mold growth. The HVAC system is also the primary way that the mold spores are transported throughout the building.

Some of the more obvious sources of moisture that become a breeding ground for mold include:

- roof leaks
- window leaks
- water forced in under doors
- louvers
- plumbing defects
- drainage problems
- grading problems.

From the general contractor to the supplier of the water sealant that was applied to the exterior basement wall, a large number of parties may be potentially responsible for the water damage and personal injury claims that may arise from mold growth.

OWNERS POINT TO CONTRACTORS FOR CREATING MOLD PROBLEMS

The problems discussed above are the subjects of an increasing number of lawsuits and claims owners are bringing against their own insurers, designers, builders, subcontractors, and product manufacturers (and their insurers and sureties). These lawsuits and claims allege that construction personnel and practices have

contributed to moisture problems that lead to mold contamination on construction projects. The following are a few examples:

- Martin County, Fla., sued its construction manager for HVAC problems that it said forced it to evacuate the county courthouse and received an $11,550,000 verdict against the CM and its surety. With interest, the ultimate judgment was over $14,000,000.
- The Hawaii Hilton in Honolulu recently closed all 453-guest rooms in its newest $95 million dollar tower because of mold contamination. Imagine the potential damages in the form of lost revenue associated with not being able to operate the hotel.
- In North Carolina, a contractor paid $6.7 million to an owner of a partially completed hotel after a sudden release of water resulted in mold contamination.

Celebrities, such as Ed MacMahon and Erin Brokovich, are in the press complaining about their mold problems. A recent Internet search for "toxic mold" pulled more than 38,000 hits. Lawsuits filed by all residents of a building, whether public housing or swank condominiums, are creating huge costs and exposure for insurers. Settlements of lawsuits of $70,000 to $150,000 are not at all uncommon — just to avoid the litigation cost.

These lawsuits often involve large numbers of parties including contractors, subcontractors, suppliers, insurers, and sureties along with *any* vendor or manufacturer of a product that can be linked to the moisture damage. What makes managing this risk almost uniquely challenging is that *no one can say what is a "safe" level of fungus exposure.* The result has changed to the construction, insurance, and surety industries in recent years.

THE ECONOMIC IMPACT OF DRAMATIC INCREASES IN MOLD-RELATED INSURANCE CLAIMS

The explosion in the number of mold-related insurance claims in the last few years has caused some industry experts to call mold claims the new asbestos, in reference to the huge losses that the insurance industry has sustained in asbestos litigation. The following examples illustrate the rise in mold-related insurance claims:

- Texas witnessed a 548% increase in mold-related insurance claims during the 16-month period between the first quarter of 2001 and the second quarter of 2002.
- Underwriting losses for 2001 ($53,000,000,000) were nearly double those for 2000, the largest loss in over 25 years.
- Homeowners' losses from mold-related claims, which are the most common type of claim, exceeded 9/11-related losses by $2.4 billion.
- Farmers Insurance reports that it received 12 mold claims in 1999, 400 mold

claims in 2000, 8,000 mold claims in the first nine months of 2001, and 2,500 mold claims in January 2002 alone.

- State Farm/Lloyds reported losses on mold-related claims of $504 million in the first eight months of 2001. This equated to $1.77 for every $1 of premium charged.

The insurance industry has responded to this increase in claims by tightening policy language to exclude from coverage all claims arising out of mold. The vast majority of both homeowner's policies and commercial general liability policies now contain clear language excluding mold-related damages. The insurance cost for some more vulnerable parts of the industry (such as EIFS or HVAC contractors, or builders of multi-family housing) have skyrocketed to the point where some people simply don't buy coverage at all. The lack of insurance coverage has led owners to look to other sources for reimbursement of the damages incurred because of mold contamination.

SURETY BONDS

Contractors and their sureties are being aggressively targeted in lawsuits arising out of the growing number of mold-related claims. As insurers fight liability for mold-related damages under policy exclusions, including pollution and contaminant exclusions, owners are looking to performance bond sureties for payment. In making these claims, owners have attributed the cause of the mold problem to a breach of the contract by the contractor and argued that the performance bond surety is responsible to cure this performance default by remediating the mold damages and repairing the construction defect.

In response to this exposure, sureties will increase attention in their underwriting to minimize the risk of mold damages. One step may include revising bond forms to exclude mold damages. This is not possible, however, in most public contracting situations in which the public entity frequently requires the bond to be on its form. Another option for sureties may be to insist that contractors obtain adequate insurance to cover mold-related property damage and personal injury claims. As noted above, this type of coverage will be expensive (if it is available at all) such that the cost of construction will rise with the incorporation of new insurance premiums into contractors' bids. Another option may be that sureties will increasingly refuse to write bonds for contractors that sureties believe cannot handle a loss.

Both sureties and insurers will heighten their scrutiny of proposed projects for potential mold-related issues, and price their products accordingly. Projects in parts of the country that are likely to have mold problems (such as the Southeast, Texas, and California) may see disproportionate increases in insurance rates, and a contractor in these areas may find it more difficult to obtain a line of surety credit.

The vast majority of both homeowner's policies and commercial general liability policies now contain clear language excluding mold-related damages.

The changes imposed upon the industry by mold-related claims require the development of risk reduction and risk-sharing methods to deal with this new landscape.

DESIGN AND CONSTRUCTION MODIFICATIONS

The construction industry has already started to identify ways to minimize the risk of mold claims and litigation. The Associated General Contractors (AGC) has published a "guidance" document addressing mold, which points out that in order to avoid mold problems, owners will have to take more time and spend more money on construction and design. There are products now available that are less susceptible to mold, but they are frequently more expensive.

Scientists writing in the *Construction Specifier* have suggested including in specifications mold- and moisture-resistant construction and finishing materials; the use of permeable wall finishes (such as paint) in place of impermeable wall finishes (such as vinyl wall covering) to avoid trapping moisture; and requiring temperature set points in HVAC systems to control humidity during unoccupied periods.

The Association of Wall and Ceiling Industries (AWCI) announced in July 2002 that it would launch its new *EIFSmart* program. The program will qualify and approve Exterior Insulation and Finish Systems contractors who demonstrate the ability to correctly install EIFS. The goal of the program is to distinguish quality EIFS contracting companies to owners, architects, and other interests such as insurers. AWCI expects this accreditation to give participating contractors a competitive edge in bidding and insurance rates.

As many authors point out, owners will have to change the way they maintain and operate buildings too. Gone will be the days when the thermostat was set at 80+ degrees in an unoccupied school or church, or the ventilation was turned off in an office building on weekends. Many of the techniques to avoid mold will drive up operating costs and reduce energy efficiency.

NEW CONTRACT TERMS AND CONDITIONS

It is likely that future construction contract negotiations will include a specific discussion of indemnification against mold-related damage. Parties may see changes in numerous contract clauses, which will impact how the risk of liability for mold-related claims is apportioned.

Hazardous conditions clauses, which historically have been very broadly written in industry form contracts, such as the AIA forms in the past, may be more narrowly drafted to specifically include or exclude responsibility for mold claims. Indemnity clauses related to mold, which expressly require the defense and indemnification of one party for claims, might become more commonplace. Contract insurance requirements

will be drafted to specifically require mold claim coverage. These contract clauses (and especially insurance requirement clauses) place contractors and subcontractors in a precarious position if they do not read their contracts carefully. The risk is that if they agree to provide something (like mold insurance) that they do not have and may not be able to get, they will be in breach of their contract.

It is important to note that the indemnity, hazardous conditions clauses, and insurance provisions that have been used in the past may very well obligate a party to be responsible for mold-related damage even if it does not expressly identify "mold" in the contract. The definition of "hazardous condition" in some contracts, for instance, is broad enough to include mold. It is in the interest of any party negotiating a construction contract to put contract terms into place, which clearly apportion the risk of mold liability. The alternative is an expensive lawsuit in which the court will decide whether the contract clauses obligate a party to pay for mold-related damages.

Mold is going to be a problem for the construction industry for at least the next few years. Insurance to cover claims will be expensive if at all possible to obtain.

Public owners will likely include specific mold-related insurance requirements in their bid specifications. Because the insurance requirements on public contracts generally cannot be negotiated or varied, contractors submitting bids and their sureties need to understand that a bid on the project is a commitment to provide the insurance required. If the low bidder cannot obtain the coverage, it could be disqualified, and its bid bond called upon. We expect to see sureties more closely scrutinize contract insurance requirements before committing to issue bid and performance bonds.

NEW LAWS/REGULATIONS

To date, no mold-related federal laws or regulations have been adopted. Michigan Representative John Conyers Jr. (D-14th) introduced "The Toxic Mold Safety and Protection Act of 2002," (HR 5040) into the 107th Congress. As introduced, the bill proposed to fund research; develop guidelines and establish standards for how much mold is too much mold; provide funds for mold remediation in public buildings; implement a national insurance program for homeowners; and direct HUD and the EPA to implement programs to certify mold inspectors and remediators. This legislation was not voted on before the 107th Congress adjourned.

Some states have enacted varying legislation pertaining to mold. The primary goal of much of the state legislation has been to bridge the gap between taxpayers who want insurance that covers mold claims but at reasonable rates, and insurers who say they cannot afford to provide this coverage at current premium levels. About ⅓ of the states have enacted legislation and another ⅓ are in the process — but there is

very little uniformity to them and the cumulative result may create real problems for the construction industry. Imagine a contractor who operates in five states and finds that it has to meet five different sets of standards and that its employees must be certified by different organizations in each location.

As more is learned about the effect of mold exposure, it is reasonable to anticipate that at some point in the future the federal government and the states will provide more uniform exposure guidelines and abatement/remediation regulations. Right now, however, the science and the legislatures are way behind the plaintiffs who are bringing claims for mold-related damages.

Mold is going to be a problem for the construction industry for at least the next few years. Insurance to cover claims will be expensive if at all possible to obtain. Developers, contractors, suppliers, and insurers and sureties will have to take aggressive steps to reduce and mange their risks to survive in the marketplace. Eventually, as more is understood about the real risks associated with mold exposure and the manner in which mold may be remediated, legislation and regulation may be necessary to address the problem. ■

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The Entrepreneurial Project Manager

Project managers in the design field must now also be business managers. No longer is it enough to drag the project in on time and under budget — they are increasingly being asked to manage existing customer relationships and develop new ones.

By David Stone

You have invested a great deal of time, effort, and expense to win the project. When the client announced that you had been awarded the job, you felt that rush of satisfaction that comes when a goal is realized. Now it's time to settle down and get the job done.

There are many components to a successfully completed project. Obviously the technical competence of you and your team count heavily in the outcome. Fortunately, technical competence (although not necessarily brilliance) is fairly easy to come by. Most projects don't fail in their ability to meet technical goals. Many do, however, fall short of the financial, schedule, client satisfaction, and general management goals that are established or assumed.

The burden of this effort falls on the project manager. Project managers take many forms. On small projects, the project manager is often lead designer, technician, draftsperson, and sometimes clerical staff. On the largest projects, the project manager is a senior staffer or principal overseeing a large team that extends throughout the firm's office and beyond. In every case, and regardless of that person's seniority status in the firm, the project manager is the individual responsible for ensuring that all the project goals are met.

There is no shortage of books and seminars that teach project management technique. The fundamental skills of scheduling, budgeting, and tracking projects are vital to success in project management. Without these most basic skills, your career

as a project manager will be, or ought to be, short-lived.

All project managers worth their salt knows how to design, schedule, and budget projects and steer them to successful completion. That's entry level stuff.

So what separates you from the amateurs? What does it take to move beyond the "kid's stuff" in project management?

The best project managers have long since realized that success in project management has to equal success in business. And successful project managers do far more than simply drag their projects across the finish line. They understand that schedule and budget compliance is the minimum requirement of project management success. They realize they need to build a much deeper set of skills and operate with a much broader outlook if they are to be successful.

> The word "client" has been replaced here with the word "customer." While "client" has been used forever in this industry, "customer" has a more personal implication. This is especially pertinent for the project manager with an entrepreneurial attitude. You have been a "customer" of many businesses and know the type of treatment that inspires you to return again and again. By thinking of your clients as "customers," the importance of high-quality "customer service" gains a higher priority and helps to add even more value to your services.

One model, which many successful project managers have adopted, is that of the entrepreneur.

An entrepreneur is a self-directed person who operates a business that takes advantage of diverse talents and resources in order to service customers and return profits. The key difference between an entrepreneur and a manager in a corporation is that the entrepreneur usually has, or behaves as if he or she has, a personal stake in the success or failure of the business. This attitude of personal ownership sets a high standard of performance in every aspect of their work. Entrepreneurs realize that, while they work together with a team to accomplish the goal, they, personally, are the driving force behind that team. While entrepreneurs may not, and often don't, actually perform the work, they are personally responsible for the quality of the work, the satisfaction of the customer, and the financial return to the shareholders.

This attitude sets the performance bar high. Without an entrepreneurial attitude, it's easy to find countless reasons why the project will or did fail. The owner didn't supply the right information. The technical staff was incompetent. The permitting agency was too slow. The budget was inadequate. Entrepreneurs, on the other hand, know that failure is not an option. If the project fails, the company fails, and they stand to lose everything. In a similar way, entrepreneurial project managers know that if the job is to be done, it's up to them. They accept no excuses and find ways to mitigate or remove the barriers to successful project completion.

What does it take to become an entrepreneurial project manager?

THE ENTREPRENEURIAL

The entrepreneur's world is like a wheel with five spokes. Each spoke carries an equal weight and demands equal attention. Should any of the spokes break, the entire wheel will collapse.

Each spoke represents an aspect of the entrepreneur's business that must be

established, tracked, and proactively managed in order to achieve success.

SPOKE #1: VISION

No business can thrive without a compelling reason for being and a strong drive to contribute in a meaningful way. This is often called "vision." The vision that a design firm has will distinguish it from competitors and provide a compelling reason for clients to select it. For the entrepreneurial project manager, "vision" is equally important, but in a slightly different manner.

There are two types of vision that are important to the project manager and both must be clearly understood and articulated.

A vision for yourself

The first type of vision defines and drives the firm and the team. What sets your firm apart from the competition? Why should a customer select your firm over someone else? What is it, besides price, that makes your firm the one to beat?

These same questions should also apply to you as a project manager. There are many project managers out there. Most are good at what they do. Some are exceptional. What do you offer a firm and a customer that they can't find elsewhere?

An entrepreneurial project manager will think of himself or herself as, "Me Incorporated." They understand that both the practice and the customer are looking for the best. They make it their personal responsibility to continually upgrade their skills and increase their value to the marketplace. By working diligently to stay at the front of the pack, these project managers establish a reputation for themselves and are constantly in demand. Customers ask for these project managers to be assigned to their projects. Firms make offers of ownership.

All these results come from the project manager who has a strong vision of his or her unique contribution to the profession. Without this strong, overriding vision, you are just another adequate project manager.

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A vision for your project

The second type of vision that the entrepreneurial project manager must cultivate is a vision about the project at hand. Every project is a unique undertaking. Each has its own origin and "hot buttons." No two projects are ever the same. Even if the scope is identical, the personalities of the participants, the culture of the organizations, and the circumstances that establish the need are always changing.

To be successful, every project must also have a strong vision. The vision statement of a project will let

everyone involved know what the team is attempting to accomplish with this work. If most of your projects seem too mundane to require or deserve a mission statement, perhaps you have become too jaded and would benefit from a higher purpose to your work!

Think about the following story that was related by the principal of a mechanical/electrical consulting firm in New Mexico.

Building better chips

Several years ago, the silicone chip giant, Intel, built an enormous manufacturing facility near Albuquerque, N.M. Every consultant for miles wanted a piece of the action, and competition was very tight. For its part, Intel insisted on making all A/E selections based on low price.

This practice was frustrating, and one consultant decided to do something about it. In an appointment with the VP of facilities, he appealed for Intel to select on value, rather than price.

The director listened attentively and then said, "Every consultant has told me how well they can help me build my facility. They have related experience, and they showed me pictures of other facilities they've built. But so far no one has talked to me about making computer chips. I am in business to make chips, not build facilities. The first consultant who comes in my office and shows me how they can help me make chips better will get all the work here, and I won't even ask the price." The purpose of that project was not to build a factory; it was to make chips better. What is the vision for the project on which you are currently working?

You can distill this vision by asking yourself:

- Why is your customer going ahead with this project?
- What are they trying to accomplish that is larger than the simple built stuff that you will provide?
- How can you show that you understand those goals?
- How can you help them achieve those larger goals?

By understanding and working from the larger goals of the project, you develop a vision that will let you bring more value to the customer than they ever could have expected. By bringing your client and your entire team into this shared vision, you stand out in the client's mind in ways which few of your competitors can match.

Don't head into another project without first establishing a powerful vision for the project. Let there be an overriding goal of accomplishment beyond the mere technical requirements of the job. With this "double vision" that includes yourself as a project manager and the project itself, you will be in demand like no other.

SPOKE #2: MARKETING

The project manager and the store clerk

Every one of us has had the experience of shopping at a store where the clerks were too busy chatting to realize we were there; where their body language spoke clearly that they weren't interested in serving us; where they made it clear we were just too much trouble. It's rare that we go back to those stores.

We have also shopped at stores where we were made to feel as if we were the

Most firms obtain between 70% and 90% of their work from repeat clients.

most important people on earth. Where nothing was too much trouble and the clerk had all the time in the world for us. We shop at these stores repeatedly.

A large store chain may spend millions on advertising. They carefully ensure the stores are stocked with the right inventory. They continually rework the look of the store so it appeals to potential customers. They do relentless market surveys to ensure their pricing is in line with their competition. All this work will be successful in bringing a new customer in the door.

Then it's up to the store clerk.

In many ways, a project manager is like that store clerk. Your firm may work tirelessly to attract new clients. You may spend thousands chasing and winning a particular project. But only when the client has the chance to experience the service available from the project delivery team, will they decide whether or not to "shop at your store" again.

Your personal marketing plan

Most firms obtain between 70% and 90% of their work from repeat clients. These are clients who have worked with the firm before and are pleased and motivated to come back to have you do additional projects.

Knowing their role as the crucial connection between the client and the repeat work they represent, the entrepreneurial project manager has a keen sense of his or her marketing responsibilities. They understand that their attitudes and actions in "customer service" will be as important in bringing the client back as their ability to complete the technical aspects of the project.

As an entrepreneurial project manager, you know that:

- You and your team have the single, most important role in the marketing effort.
- You are the point where all the marketing hype is validated or disproved.
- You alone have the power to bring a customer back, or send them away forever.
- You are the person on whom the client depends to get the job done.
- You have direct, personal responsibility for the level of service and quality throughout the project.
- You have a direct responsibility to ensure a continuing supply of work.

With this understanding, you and your team will establish "personal marketing plans" that are implemented every day, in every situation.

More "personal marketing"

Most project teams, when asked to participate in marketing, immediately envision making those dreaded cold calls that most design professionals will do anything in their power to avoid. You can assure your team this is not their highest

and best use and, while they will be asked to interact with clients, they will not be required to do telemarketing.

Establish your entrepreneurial and personal marketing plan by reviewing these questions with your team:

1. *How aware are you and your team of your role in turning customers away or bringing them back?*
2. *What can you do to make that "shopping" experience memorable for your customer during:*
   - Meetings
   - Phone calls
   - Project updates
   - Regular communications.
3. *Are you always on the lookout for opportunities for:*
   - Additional service opportunities
   - Other projects
   - Client maintenance opportunities
   - Other likely clients
   - Network building opportunities
   - Networking opportunities
   - Ways to make your client look good
   - Public relations opportunities
   - Good client references and testimonials
   - Post project communications opportunities.

By recognizing yourselves as that vital, personal link between the customer and your firm, you can easily identify the simple, everyday actions that will inspire your customers to come back project after project.

SPOKE #3: FINANCE

There is no escaping the fact that one of the project manager's primary responsibilities is to manage the project finances and ensure the job returns a profit to the firm. The entrepreneurial project manager will take this responsibility very seriously and will educate himself or herself on the subtleties of project and firm finances, including:

- How hourly rates are established
- Calculating and compiling fees
- Profit: what it is, what it isn't, why you need it.
- Overhead rates
- Key financial indicators.

These subjects give you the knowledge necessary to budget your projects and set adequate fees. They will also teach you how project finances merge into overall firm finances and contribute or detract from the health of your company.

When focusing on the finances of the project itself, the entrepreneurial project manager will learn how to work with, monitor, and manage project finances to steer the job to successful and profitable completion.

Many firms have some type of computer-based job-costing and tracking system in place. In fact, the most popular software programs are far more powerful and sophisticated than is necessary. It is certainly the case that most project managers and many firm principals don't understand how the system works, what the various reports mean, and how to interpret and act on the data provided. As a result, few firms are actually using the capability they possess.

The entrepreneurial project manager, on the other hand:

- Learns how to plan a project so it can be tracked carefully
- Forecasts project expenditures before the job begins
- Tracks expenditures and determines schedule and budget status on a weekly or even daily basis
- Accurately assesses actual percentage completion
- Regularly compares actual completion to budget and schedule consumed
- Knows exactly where his or her project stands at every step along the way
- Treats project management as a continual series of minor course corrections
- Takes early corrective action to keep projects ahead of schedule and under budget.

Finally, profit should be a special topic of interest to the entrepreneurial project manager. It is the project manager's job to deliver a profit on every project. The fact that your project is profitable should not be a remarkable accomplishment, it should be the normal course of events. While there are occasions when you may anticipate, for marketing or other purposes, to have a project that does not make a profit, these situations are rare and always preplanned. The entrepreneurial project manager assumes responsibility for always delivering a profit and satisfying the customer's needs.

SPOKE #4: HUMAN RESOURCES

Design professionals do not deal in inventory or machinery, they deal in ideas that are generated and implemented by trained and talented people. The resources that project managers use to accomplish their work are human.

As an entrepreneurial project manager, you must learn to understand and deal with those human resources on two levels:

1. You must first learn to understand and manage yourself.
2. Then you can move forward to understanding and managing your team.

Understanding and managing your own personal human resource

One of the characteristics of project managers in this industry is that virtually every one has begun their career as a design professional — an architect, an engineer, a planner, an interior designer, etc. They went to school and worked hard to achieve that goal and were motivated to work hard at improving those skills. In most cases, these dedicated professionals distinguished themselves in their profession and were rewarded with a promotion to the role of project manager.

While this seems to make perfect sense, there's a flaw in the logic. It's rare to find the architect or engineer who went through their university education looking

It's rare to find the architect or engineer who went through their university education looking forward to the day they could schedule and budget projects.

forward to the day they could schedule and budget projects. The subject matter was hardly mentioned in school and no one pressured faculty for courses in project management.

Once into the working world, practitioners quickly discovered the vital need for project management, but it was seen, like laundry, as something that had to be done, not something you would choose to do.

Among the many people involved in this profession, some seem to have been born with a natural talent for project management. They are easily recognizable and respected for their abilities. When other design professionals are asked to list the characteristics of the best project managers they have ever known or worked with, characteristics similar to the following are invariably mentioned:

- Good communicator
- Well-organized
- Good listener
- Understands the "big picture"
- Inspiring leader
- Team player
- Motivates others
- Manages time well
- Delegates work effectively
- Technically competent
- Rarely gets flustered.

In workshop after workshop, where participants are asked to characterize their favorite project managers, these traits are listed. Significantly, out of 10 characteristics listed, the characteristic of "technical competence" is usually mentioned near the end. What do we learn from this simple exercise?

The important lesson here is that the important skills necessary for success in project management are not those in which most design professionals have been trained. A quick look at the list confirms that few engineering or architectural schools offer courses in "being a good listener" or "delegating work effectively." A project manager with these skills was either born with them or learned them somewhere else.

Rising out of this question is the reasonable notion that you might not want to be a project manager. When you're promoted to project manager status it often means you get to do less of the technical and design work that you like to do. Is the thinking process that takes someone with superb technical capabilities and promotes them to a position where these skills are less important than "people" skills (where they have little or no training) somewhat twisted?

Ask yourself if you have or want to acquire the personal skills it takes to be a successful, entrepreneurial project manager?

- Are you content to let others do much of the technical or design work on a project?
- Do you prefer the atmosphere of a team or do you work best alone?
- When things go wrong, do you mind taking the heat?
- Would you rather be the coach or the star player?
- Can you work well under stressful conditions?

This self-inspection is vital if you want to move forward to being a successful project manager. If you determine that this career path is for you, it's time to start investing in your own "human resource management" by upgrading your skills in:

- Interpersonal communications
- Time management
- Supervision and delegation
- Leadership skills
- Written and oral communications
- Stress management
- Negotiating.

Understanding and managing your team

If the resources a project manager must use to accomplish his or her work are human, they must learn how to manage those resources. Unlike managing equipment, machinery, or inventory, human resources pose a particular challenge.

Perhaps making the project manager's job even more challenging is the fact that the human resources in the design professions are highly trained, highly intelligent, and self-directed individuals. Each has his or her own strong opinions of how things ought to be and often resist being told what to do. The management of groups like this has often been referred to as "herding cats."

Your job is to build a team and then nurture that team so it sets and then exceeds its own high standards of performance.

Recruiting and motivating

While we all know how hard it is to find good talent, the best people are always attracted to work with the best project managers. Your job is to set your project standards high enough to attract the best talent that's out there. A really fine firm and its best project managers never have trouble finding good talent.

As an entrepreneurial project manager, you have an ongoing need to attract, recruit, and train top talent. The best way to do this is to make your team a "talent magnet" by:

- Setting your standards high and sticking to them
- Understanding that individual team members have differing levels of interest in a project
- Acquainting yourself with your team members and learning what drives them

- Recognizing individual achievements, contributions, and quality work, with open praise
- Writing a memorandum of praise and placing a copy in their personnel record
- Knowing that reward or recognition should be immediate or the value to the recipient diminishes
- Keeping any corrections or reproofs that are necessary prompt and directly related to the event that triggered them
- Keeping your admonitions for mistakes or poor performance completely private
- Knowing that an employee's time is their most valuable commodity and recognizing and rewarding their contributions.

Delegating

Always remember that your title is project manager, not project doer. As a manager, your task is to leverage the efforts of others towards the completion of work.

Always

- Begin with preparation and systematically plan what to delegate and what to do yourself.
- Think through the activities the team member will need to do to complete an assignment.
- Specifically outline the individual's or team's responsibilities.
- Ask for feedback to ensure the assignment has been fully understood; one of the most frequent mistakes made by project managers is assuming that other people understand what's going on and know what they are doing.
- Challenge the time estimate to complete any task. Given the option, everyone will ask for more time to complete a task than may be necessary. However, you must always work with the staff and team to get their "buy-in" to your schedule. If they don't believe from the outset that it can be accomplished, the schedule will fail.
- Grant the team member enough authority to complete the assignment.
- Be certain the individual has the resources to do the job.
- Check periodically to determine if you've given too much or too little authority and adjust appropriately.
- Ask the team member if you've provided enough information.
- Focus on what needs to be done, not how to do it.
- Take time to review completed assignments.
- Thank a team member and show that you notice high-quality work.

Never

- Let two or more individuals be responsible for the same task.
- Overly structure the assignment so the individual has no latitude to make decisions.
- Demand that the individual work in exactly the same manner as you would. (This removes authority, responsibility and creativity. Instead, focus on the end result, not the step-by-step means of getting there.)
- Redo the assignment yourself; nothing undermines trust greater.
- Avoid confronting a team member about substandard performance.

Red flags

You know you need to improve your delegation skills if:

- You're just too busy — you are under constant pressure, usually miss personal deadlines, or spend a great deal of time on activities that you would not personally pay your charge-out rate for.
- You're often surprised by team members doing things other than what you expected or intended, and job quality is below the standards you expect.
- Productivity is low or dropping and team members seem less efficient and unmotivated.

SPOKE #5: DELIVERY SYSTEMS

Process vs. project

Most businesses that breed successful entrepreneurs are "process" driven. This means they establish a successful process for accomplishing work or producing a product and then manage that process. Projects and products come and go, but the process by which they are developed and completed gives the company its strength and competitive advantage. Over time, continuous fine-tuning and adjustment of the process makes it better and more profitable.

Design professionals, on the other hand, are "project" driven. They work from one project to the next with little regard for a standardized process that would make the production of work faster, easier, more accurate, and more profitable. With an intense focus on maximizing billable time, the incremental improvements that are made in the "process" are developed in rare moments of "stolen" time. Compounding this problem is the strong belief that every project is different and should be approached with a "clean slate" in order to give the client maximum value. Making a standardized process even more challenging is the "herd of cats," each of whom vigorously defends what they believe to be the best process.

The entrepreneurial project manager recognizes this dilemma and works to balance the need for standardized processes against the value of a unique approach.

The entrepreneurial project manager will find the best processes and systems that will allow him or her to accomplish projects faster, more accurately, and at lower cost. Once they have found these processes, they are very intolerant of individuals who take it upon themselves to use a different set of standards or procedures and undermine the strength of the team. If adjustments or changes are to be made in the process, they will be reviewed, tested, and adopted by the team, not by individuals at their own discretion.

Standard procedures

Why do you need standards? In general the most significant advantage offered by any

standard procedure is the ability to reuse and leverage previous efforts. In order to do this effectively any standard must be:

- Easy to find, understand, and use
- Consistently formatted
- Usefully organized
- Accessible to everyone.

Standards should never exist for their own sake. Your firm lives and grows on knowledge and information, which is the foundation of the value you bring to your clients. The use of standard procedures allows that information to be judged by the same criteria listed above and makes it available for effective reuse. In addition, standards will:

- Improve the way you communicate and coordinate information
- Allow you to reuse and benefit from your highest quality work
- Increase productivity by reducing repetitive effort.

However, unless everyone adheres to your standards, your office and especially your computer capability will only experience dramatically increased overhead costs. Standards must be universally accepted and adhered to within your team. There are plenty of firms who claim to have developed standards and who can dust off the manual to prove it. But when you look at the computer terminals, the filing cabinets, the correspondence going out of the office, and the schedules and budgets being prepared, it's everyone for themselves!

Types of standards

Standards fall into three categories, and each is equally important to be addressed.

1. Standards of organization

For example:

- Computer and paper filing and storage systems
- Consistent file and document naming
- CADD layering organization

2. Standards of communication

For example:

- Graphic standards
- Symbol and detail libraries
- Standard forms and templates
- Letter and memo writing
- Meetings and their minutes

3. Standards of procedure

For example:

- Scheduling techniques
- Task delegation

- Preparation and documentation of calculations
- Review and quality control
- Project monitoring and reporting practices

As you develop a set of office and team standards, keep these principles in mind:

1. The standards should be kept as simple and straightforward as possible. Complexity for its own sake only adds to confusion and resistance to the use of the standards.
2. Stay away from committees. Assign only one or two people who can focus on the work, not the committee.
3. Give those assigned to develop the standards a strict and short deadline and then allow them time to get it done. Do not expect this type of work to be done as an extracurricular activity.
4. Assume that the standards that are developed will continuously evolve. This will be an ongoing process as you work with the standards and discover weaknesses or better alternatives.
5. Prepare a printed manual and distribute it to everyone. Hold a meeting to present and discuss the standards. Make sure everyone is aware of them and the importance of adhering to them.
6. Enforce the standards by refusing to accept work that is not in conformance. Unless they know you are serious, the entire effort is a waste of time.
7. Establish a regular schedule for the review and revision of each section. Focus on a different section every three months. Encourage your team to submit their ideas and experiences with the standards and include those comments in the review process.
8. Keep the manual revised and updated regularly. Develop the habit of issuing the next update on a regular basis. Don't allow the manual to collect dust.
9. Hold regular gatherings to discuss and review the standards and educate your team about new developments.

HOW DOES A PROJECT MANAGER BECOME AN ENTREPRENEUR?

The model of the entrepreneurial project manager is one that can drive your project success rate to new heights. It does, however, call for a change of thinking on your part. The world of the entrepreneur is not familiar to most design professionals, and you need to make an active decision to adjust your thought process. Do this by:

Exposing yourself to the entrepreneurial world

- Join a business roundtable or a weekly breakfast meeting of local business people through your chamber of commerce. Get the outside perspective they can provide on the world of business in general and their specific buying needs and habits.
- Determine to learn something new from an industry other than yours. What can you learn from retail, banking, and manufacturing that could be useful to your operation? While it's unlikely you will learn methods that can be directly translated into your practice, be open-minded about how you could adapt their strategies to your advantage.

- Subscribe to and read business journals. While you must continue to keep abreast of professional issues reported in the architectural and engineering journals, add a monthly small business magazine to your reading list. Pick up a copy of *Inc., Success, Fortune, Entrepreneur* or other general business publications. Again, keep your mind open for what you can learn from other entrepreneurs who face many of the same struggles as you.
- Establish an advisory board made up of individuals who are not from your firm or even your profession. Let this board meet quarterly or twice yearly to review your progress, help you set goals, and provide their detached, outside-perspective views on the world-at-large and your place in it.

Setting specific entrepreneurial performance goals

- Twice per year, sit down and establish a set of profit goals for your projects. By working together to set these targets, you will have a high level of commitment from everyone to achieve your goals.
- Establish a measurable set of customer satisfaction ratings. Take an initial survey of your existing clients to establish a base line, then conduct yearly surveys to monitor improving performance.
- Invite peer review of your project management techniques on a regular basis. Keep a scorecard of your performance in each category and set new goals for achievement each year.

Measuring entrepreneurial performance

- Get competitive! Monitor professional surveys and business reports to see how your growth and performance ranks against peers and competitors. Establish the key indicators that are most important to you and set annual goals for improved performance.
- Chart progress regularly. Keep your entire team informed of your entrepreneurial performance. Only when these performance issues are kept front and center will they become important in the day-to-day decision-making and thought process of your team.

Rewarding entrepreneurial performance

- Celebrate success and recognize individual and team accomplishments. If you fail to reinforce this mode of thinking, it will quickly fade and your high-performance team will return to the standard methods of doing business in the design professions.
- If you and your team are going to think like entrepreneurs, you should be rewarded like entrepreneurs. Be sure, though, that you aren't providing exceptional rewards for merely adequate performance. Remember, a project manager's job is to deliver a profit on every project. Only when the budgeted profit, or some other predetermined standard is exceeded, should rewards be shared. ■

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TEST YOUR KNOWLEDGE

Answer either True or False in response to each of the following statements.

1. As long as the project comes in on time and budget, the project manager is doing his or her job.
2. The "customers" of a design firm have expectations similar to those of most other businesses.
3. An entrepreneurial project manager is always working to upgrade the value he or she can bring to customers.
4. As long as you and your team understand the scope of the work, you can do an acceptable job.
5. The project manager is the front line representative of the firm and is primarily responsible for a customer's decision to come back.
6. Project managers don't need to understand overall firm finances if they keep their projects profitable.
7. The best project managers have mastered the softer, interpersonal skills as well as technical and financial skills.
8. Managing a team of design professionals is like herding cats.
9. Design professionals can learn valuable lessons from other industries that are more process-driven.
10. Joining a business roundtable provides a project manager with good marketing opportunities, but nothing more.

Answers

1. **F** 2. **T** 3. **T** 4. **F** 5. **T** 6. **F** 7. **T** 8. **T** 9. **T** 10. **F**

Score Yourself

9 – 10 GREAT

You are ready to enter the entrepreneurial world and you will likely make Bill Gates nervous.

7 – 8 GOOD

Since this is such a vital topic for your success, you should probably review this article again.

0 – 6 POOR

Better let someone else run your projects until you have time to go over this article again in detail!

Partnering Commitment Equals Success

A highway reconstruction project reveals that a full commitment to the partnering process helps the project team deal with common issues within the design-build environment.

By Bill Spragins

The $1.7 billion design-build T-REX project in Denver has met with success 25 months into the five-year project. A full commitment to the partnering process from the executive level through to the task force discipline teams has helped the project team deal with the continual flow of issues common within the design-build environment.

T-REX is the reconstruction of I-25 for over 12 miles from Broadway Street in south-central Denver down to Lincoln Avenue through the business area called the "Tech Center." It is the largest multi-modal project in the country. The joint owner team is the Colorado Department of Transportation (CDOT) and the Regional Transportation District (RTD). The design-build team is Southeast Corridor Constructors (SECC), comprised of Kiewit Construction and Parsons Transportation. The scope of the project includes:

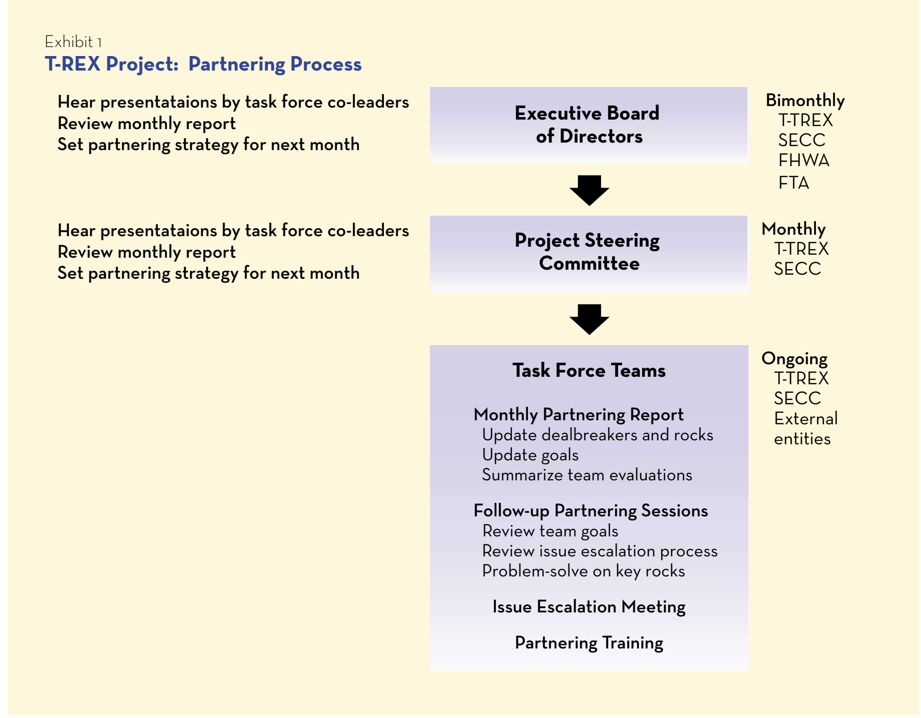
- Adding one lane on each side of the highway from Broadway to the I-225 interchange
- Adding two lanes on each side of the highway from I-225 to Lincoln Avenue
- Constructing light-rail along the entire corridor and from I-225 to Parker Road
- Maintaining three lanes of traffic during daylight hours in each direction

T-REX is the largest of the new generation of design-build transportation projects that has been constructed around the country in the last decade. The successful $1.2 billion I-15 project in Salt Lake City, the immediate predecessor design-build project, focused on schedule to complete before the 2002 Olympics. T-REX differs from I-15 in that the focus is on achieving minimal impact to the traveling public by keeping six lanes of traffic open while construction is in progress. Accomplishing this in a major urban area affecting multiple municipalities makes this an extremely complicated project.

Successes on this complex project have included:

- Maintaining a 3.3 project incident rate vs. the 8.8 industry average rate for safety
- Having an 80% public recognition of the project in Colorado
- Receiving a 75% public approval rating
- Staying on schedule (32% complete)
- Being within budget
- Implementing a premier noise variance/mitigation program in the country
- Having a $250 million positive impact to the local economy.

The partnering process on the T-REX project (Exhibit 1) has been developed based on the principles of collaboration, accountability, and consistency. Collaboration among all team members is critical in a design-build environment where the number of issues requiring decisions and the speed of decision making increases dramatically from the typical design-bid-build project delivery method. Individual accountability is crucial within an organization that developed as quickly as the T-REX organization



Collaboration among all team members is critical in a design-build environment where the number of issues requiring decisions and the speed of decision making increases dramatically from the typical design-bid-build project delivery method.

and will continually evolve as the various phases of the project initiate and complete. Finally, consistent communication is essential within an organization comprised of over 20 task-force teams.

The partnering process has been implemented at the executive level and throughout the task-force teams as follows.

EXECUTIVE-LEVEL PARTNERING

The active support and commitment of senior managers is critical to the success of any partnering endeavor. On T-REX, executives from CDOT, RTD, FHWA, FTA and their counterparts from Southeast Corridor Constructors began meeting in July 2001 in bi-monthly board of directors partnering sessions. At the initial session, a project charter of mutual goals was finalized, a team evaluation process established, and principles on issue escalation agreed to. At the continuing sessions, the team goals were reviewed, project status was provided by the project management team, any key issues were discussed, and action plans were established.

PROJECT-LEVEL PARTNERING

The comprehensive approach to partnering involving the project management team through the 20-plus task-force teams has included the following activities.

Initial partnering sessions

Each task-form team held their own initial partnering session to develop team goals and an issue escalation ladder specific to their discipline needs. Follow-up sessions are being held periodically throughout the project.

Monthly Partnering Reports

The co-leads of each task force team submits a monthly report that summarizes deal-breakers (issues where task force members are in disagreement, and have reached an impasse and require escalation); rocks (issues that are being worked on but do not need escalation); goal progress; and status of team relationships. These reports are then rolled up into a master report of all task-force teams that is reviewed by the project management steering committee once per month. Co-leads from select task force teams are rotated into this meeting to provide an in-depth explanation of their monthly team results. The information generated from these reports is consolidated and presented to the executive board of directors bi-monthly.

Exhibit 2

T-REX Project: Issue Resolution/Escalation Process

Partnering does not eliminate all of the issues on a project. The purpose of the issue resolution/escalation process is to ensure that any disagreements or disputes among team members are resolved timely and in an equitable manner. This helps foster a productive business relationship on the project among all team members.

Issue Escalation Ladder

Level	
Level 1	**Task Force Teams** T-REX SECC
Level 2	**Task Force Co-Leads** T-REX SECC
Level 3	**Discipline Managers** T-REX SECC
Level 4	**Primary Management Teams** Larry Warner, T-REX Rick Clarke, T-REX Bill Murphy, SECC
Level 5	**Executive Team** Tom Norton, CDOT Cal Marsella, RTD Al Kirkwood/Steve Hansen, SECC
Dispute Review Board	Robert Smith, Chair Bill Peckham Ray Dodson

Issue Escalation Process

If a specific issue cannot be resolved by the T-REX and SECC representatives at a given level, resulting in a disagreement or an impasse at problem resolution, then the issue must be escalated to the next level of management with the following information prepared:

Project goal(s) impacted and contract provisions affected
Facts to the issue
Actions taken to date
Proposed resolutions
Timeline needed to resolve the issue

If an issue cannot be resolved following the issue escalation process, the issue is presented to a Dispute Review Board (DRB). The DRB is comprised of three members with the chair to be a lawyer or retired judge. The contractor may appeal the final DRB decision in accordance with C.R.S. § 24-4-106.

Issue Escalation Meetings

When task force members or co-leads reach an impasse on the resolution of a specific issue, the partnering process requires them to escalate the issue to the next level of management (see Exhibit 2). The issue is either resolved or continues to be escalated through the levels of management. If all levels of management are exhausted in this effort, the issue can be taken to a neutral dispute review board, which exists to assist the team in resolving the issue.

As the T-REX project transitions from design/construct to pure construction this year, numerous challenges remain for the team. However, momentum from the successful start should be sustained and can be attributed to the following lessons learned from effectively implementing the partnering process on a large design/build project:

- Absolute commitment to the partnering process is required in both involvement from key personnel and investment in time and dollars
- Constant follow-up and reinforcement of the process is required to instill and maintain proper behaviors
- The owner and design/build construction teams should appear and function seamlessly to each other, regardless of how many separate organizations are involved

- Task force and discipline teams should function as integrated teams
- The issues will always be there — focus on consistent processes that will help in the resolution of those issues. ■

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