

2C11

Business economics and entrepreneurship

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Lecture 2: Business strategies and business development in construction companies (29/04/2014)

European Erasmus Mundus Master Course

Sustainable Constructions

under Natural Hazards and Catastrophic Events

520121-1-2011-1-CZ-ERA MUNDUS-EMMC

LIST OF LECTURES

Lectures

- L1 Trends and challenges for the construction industry
- L2 Business strategies and business development in construction companies
- L3 Financial management in construction companies
- L4 Project management – generalities
- L5 Project management – support activities
- L6 Project management systems applied in constructions
- L7 Entrepreneurship issues
- L8 Standard contracts in civil engineering
- L9 Risk management in construction company
- L10 Summary and discussion of the exam questions

Applications

- A1 General presentation of the case study (WTP – Hunedoara)
- A2 Financial analysis and management in construction company (WTP – Hunedoara)
- A3 Cash flow analysis (WTP – Hunedoara)
- A4 Visit – WTP Hunedoara
- A5 Project's presentation

L2 BUSINESS STRATEGIES AND BUSINESS DEVELOPMENT IN CONSTRUCTION COMPANIES

OBJECTIVES

- **Student understands which are the challenges and responsibilities related to the construction business**
- **Student acquires information about the structure of a business plan in order to implement practically its knowledge**
- **Student is familiar with the strategic planning associated to the construction industry**

L2 BUSINESS STRATEGIES AND BUSINESS DEVELOPMENT IN CONSTRUCTION COMPANIES

TOPICS

I. CONSTRUCTION BUSINESS

- Definition
- Challenges
- Business responsibilities
- Business failure

II. BUSINESS PLAN

- Introduction/Executive summary
- Business description
- Organizational structure
- Market analysis
- Investment objectives and planning
- Financial planning
- Risks

III. STRATEGIC PLANNING

- Leadership
- Competitive advantages
- Integration
- Strategy
- Building Industry Game



TOPICS

I. CONSTRUCTION BUSINESS

- **Definition**
- **Challenges**
- **Business responsibilities**
- **Business failure**

Section developed by Aleš Tomek

I. CONSTRUCTION BUSINESS

Definition of the activity

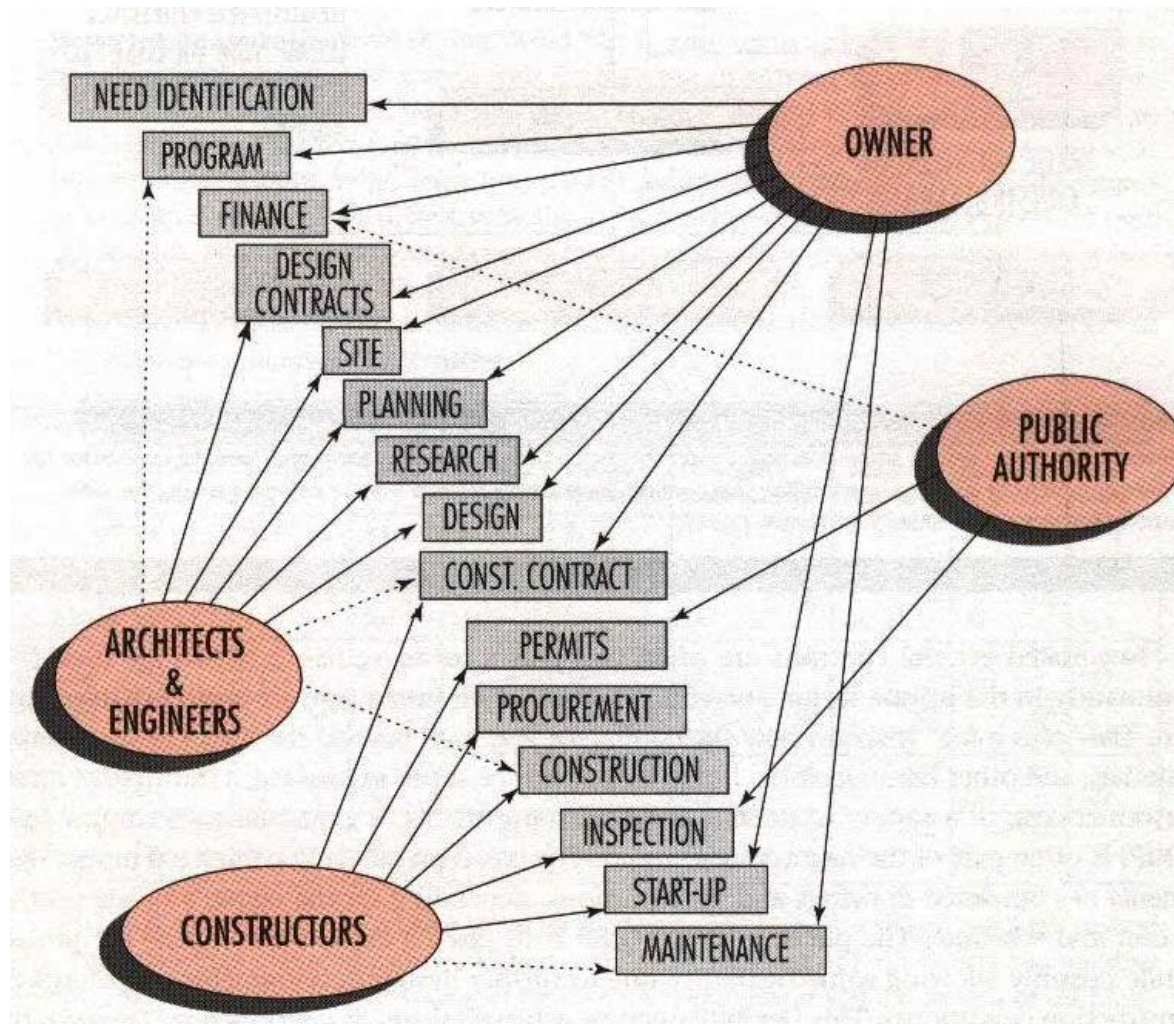
Construction involves the **combination of** materials, people, and equipment on a project site and assembling the materials in the proper sequence to construct a project that meets the customer's requirements (...and generates profit).

These projects may range from an **individual home** to a **sophisticated infrastructure** project, such as a regional airport or a major transportation system.



I. CONSTRUCTION BUSINESS

Definition of the activity





I. CONSTRUCTION BUSINESS

TOPICS

CONSTRUCTION BUSINESS

- **Definition**
- **Challenges**
- **Business responsibilities**
- **Business failure**

I. CONSTRUCTION BUSINESS

Challenges

- the revenue generated by the construction activity exceeds the cost of doing the work (**make profit**)
- the company has adequate demand for its services
- the company has a skilled, motivated workforce of sufficient size to meet anticipated requirements
- the company has adequate financial resources to finance construction projects
- the cost of the company overhead is affordable based on the projected workload
- the company has the ability to manage the unforeseen events affecting its business

I. CONSTRUCTION BUSINESS

Challenges

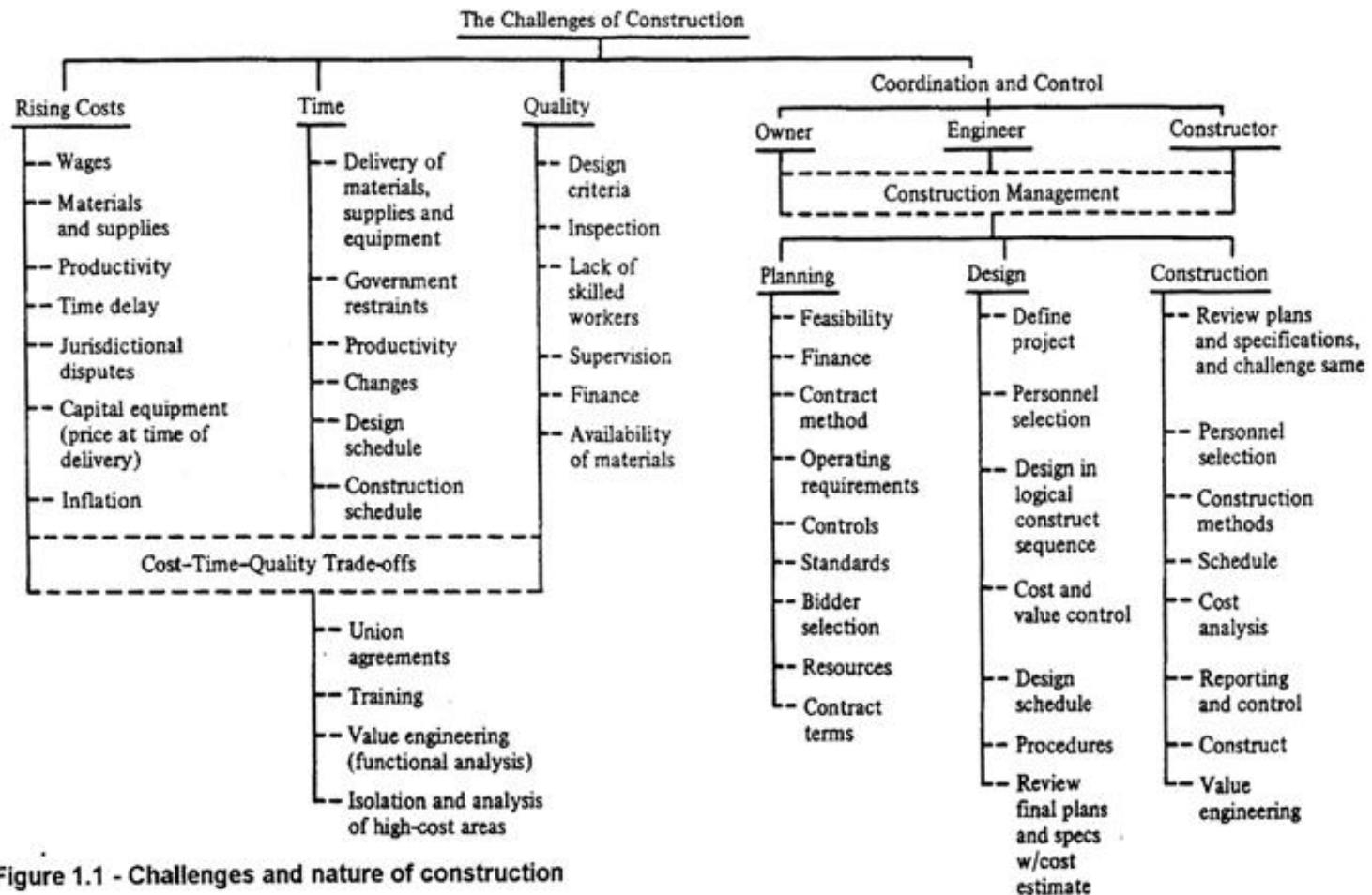


Figure 1.1 - Challenges and nature of construction



I. CONSTRUCTION BUSINESS

TOPICS

CONSTRUCTION BUSINESS

- **Definition**
- **Challenges**
- **Business responsibilities**
- **Business failure**

I. CONSTRUCTION BUSINESS

Business responsibilities

- acquisition of the works
- performance of the works in accordance with the contract requirements
- quality requirements according to applicable norms and standards
- management of the financial, capital, and human resources of the firm
- health and safety requirements



I. CONSTRUCTION BUSINESS

TOPICS

CONSTRUCTION BUSINESS

- **Definition**
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- **Business failure**

I. CONSTRUCTION BUSINESS

Business failure

- Few construction firms **fail** from a single cause or from a sudden, catastrophic event
- The primary causes of failure can be grouped into two categories: external influences and internal problems.

External Influences

- prolonged economic recession
- loss of a major customer
- new competition
- shortage of skilled workers

I. CONSTRUCTION BUSINESS

Business failure

Internal causes (associated with the lack of strategic planning)

- **Pursuit of volume.** Business volume (people, plants) is a measure of success. The **pursuit of volume without a corresponding increase in profitability** places the economic viability of the construction firm at risk.
- **Lack of comprehensive business plan.** Construction companies often do not have **business plans** that guide their business decisions. They simply react to the market.
- **Diversifying into unfamiliar types of projects or geographic area.** Appropriate suppliers and subcontractors may **not be known**, and the technical requirements may **exceed** the expertise of the company's project management staff. Unfamiliar contracting approaches lead to cost underestimation. The location of the new market is a **significant distance** from the company's normal area of operation, there will be little ability to augment project management staff with other company resources.

I. CONSTRUCTION BUSINESS

Business failure

Internal causes (associated with the lack of strategic planning)

- **Lack of managerial maturity.** As a firm grows, its management system must cope with increased scope of work. Additional managers are needed, and the founders must **delegate some authority** for making business decisions to others.
- **Increase in project size.** The **size of the project** in relation to the capabilities of the firm may lead to significant financial problems. One large unprofitable project will have a greater adverse impact than will a small unprofitable project.
- **Unplanned loss of key personnel.** It can severely stress construction firms, particularly small ones. Unplanned loss of **management or technical expertise** may take considerable time to overcome and places small firms at great risk.
- **Poor cost-estimating skills.** To ensure that a company remains a profitable business, construction firm managers must **anticipate costs and risks** of each project and price of the work at a level to cover all costs and provide a profit.

I. CONSTRUCTION BUSINESS

Business failure

Internal causes (associated with the lack of strategic planning)

- **Lack of equipment control.** Controlling equipment costs is controlling the amount of equipment owned, leased, or rented. **Investing too much** of a company's financial resources in equipment may degrade the firm's ability to finance its cash flow requirements. **Idle equipment*** represents an overhead cost that should be avoided.
- **Poor internal communications.** Poor internal communications between project sites and the home office plague many construction companies. Consequently, there may be **little warning** of project execution problems or financial difficulties.
- **Poor use of accounting system.** delayed customer payment often results in inadequate cash flow. By not using the current balance sheet, income statement, and job cost reports, managers may be unable to identify financial difficulties until it is too late to take corrective action.
- **Excessive debt.** The cost of borrowing should be included in company overhead margins.

** The cost of equipment that remains on site ready for use but is placed in a standby basis*

II. BUSINESS PLAN

Business planning requires an understanding of the market, procurement, the competitive advantages, services to be offered, the selection of market area, the selection of people and equipment required, the funds needed.

? What business am I in? What do I sell? Where is my market? Who will buy? Who is my competition? What is my sales strategy? How much money is needed to operate my firm? How will I get the work done? What management controls are needed? How can they be carried out? When should I revise my plan? Where can I go for help?

BUSINESS PLAN

- **Introduction/Executive summary**
- **Business description**
- **Organizational structure**
- **Market analysis**
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- **Risks**



II. BUSINESS PLAN

Executive summary

- Main objectives of the company (i.e. became the largest player on the X market in the residential building field)
- Sales summary (quantities, revenues, profit margin – recorded or anticipated)
- Strategic positioning (i.e. residential buildings with steel structure)
- Strategic alliances (if necessary)
- Investment description (i.e. structural steel detailing software for design of all steel structures)
- Key advantages generated by the investment (i.e. simulation, resistance, cost reduction, better quality)
- Funds required (i.e. 25% own funds, 75% bank loan).



II. BUSINESS PLAN

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II. BUSINESS PLAN

Business description

- **Legal information** about the entity: name, type of organization, owners, registration number, etc.
- **Domain of activity:** products, services,
- **Goals** may include increasing monthly sales or profits to some specific number or by a specific percentage; decreasing costs or operating expenses to a specific number or percent; using new technologies; finding new funding sources.
- **Mission Statement** defines the long-term goals of your business in three ways: What does your company do for its customers? What does your company do for its employees? What do you want from your business?
- **Vision.** Actually, the vision statement is about what the business's future will look like if the mission is achieved.
- **Historical background** (if it is the case): market share, key financial indicators (revenues, expenditures, assets, profitability, investments)
!!! Income statement and balance sheet in appendix.

II. BUSINESS PLAN

TOPICS

BUSINESS PLAN

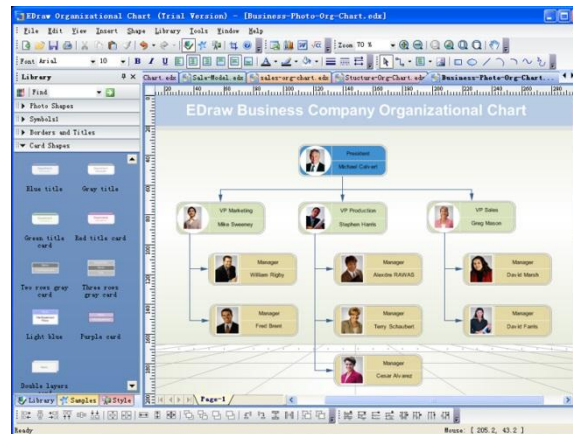
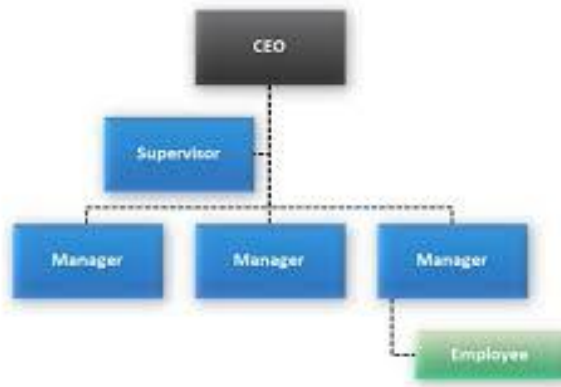
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II. BUSINESS PLAN

Organizational structure

- **Management and personnel**
- **Staffing** (the process of acquiring, deploying, and retaining a workforce)
- **Personnel analysis & expenditures** (management %, wages, age, etc.)
- **Administrative organization** (branches, working points, etc.)
- **Organization chart**

Hierarchy Template



II. BUSINESS PLAN

TOPICS

BUSINESS PLAN

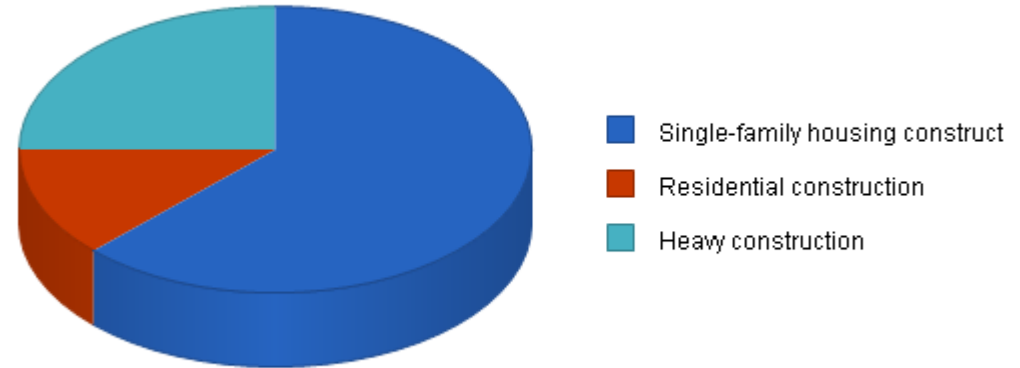
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II. BUSINESS PLAN

Market analysis

- Market presentation
 - Segmentation
 - Clients
 - Suppliers
 - Competitors (direct or indirect)

Market Analysis (Pie)



Clients (%)	Suppliers (%)	Main competitors (% of market share)
X (15 %)	A (60 %)	α (25 %)
Y (10%)	B (30%)	β (10%)
Z (8%)	C (10 %)	γ (8 %)
Others (67%)		Others (50%)

http://www.bplans.com/building_construction_business_plan/market_analysis_summary_fc.php

II. BUSINESS PLAN

Market analysis

- Marketing strategy
 - Prices
 - Distribution channels
 - Product mix
 - Advertising
 - Promotional Campaign

Pricing Strategy Checklist
1. What is your pricing-level philosophy? Are your prices the high-end, middle-of-the-pack, or low-end choice? If you have high-end prices, do you offer extra value? If your prices are lower, what affects your lower price and can your pricing sustain profitability? How do you plan to maintain or adjust your pricing level over the business plan period?
2. What is your pricing structure? Do you offer all-inclusive pricing or pricing for a base-level product plus add-on prices for service, guarantees, delivery, and so on? A single price level or multiple price levels from which to choose? Pricing by the project or product delivered or by the time and costs involved? A free base-level product with premium-level options available for a price? Pricing based on frequent discounts through promotional offers, quantity discounts, or other deals or incentives? How do you plan to adjust your pricing structure over the business plan period?
3. What pricing and payment options do you offer? Do you offer introductory pricing to gain trial and acceptance, increasing prices later? Do you allow bargaining? Do you offer financing? Do you offer a range of payment options? Do you offer contract, subscription, or bulk-order discounts? How will you adjust your pricing and payment options over the business plan period?
4. Pricing considerations... Do your prices cover all costs plus a profit margin? Do your prices cover costs such as shrinkage, returns, bad debt, and allowances for employee errors? Do you know how each pricing and payment option impacts your financial condition? Do you — or can you — join a buying group, buy through an association, or establish bulk-buying agreements to reduce the costs of your product? How do you plan to adjust pricing over the business plan period?

Distribution Strategy Checklist
1. Will you introduce new distribution or delivery systems — such as home delivery, subscription delivery, free delivery to volume customers, free shipping or guaranteed returns with online purchases, and so on — to increase sales, serve customers, or gain advantage over competitors?
2. Can you increase sales by adding new distribution channels, such as online sales, distributor relationships, or new retail outlets?
3. Would your business benefit from business partnerships that allow you to achieve off-premise sales outlets in other retail settings?
4. If you use or are adding distributors or representatives, do you have adequate plans for recruiting, training, motivating, and compensating them, and do you have a clear plan for assignment of territories?
5. Other distribution strategy considerations...

<http://www.dummies.com/how-to/content/business-marketing-plan-distribution-pricing-and-p.html>

II. BUSINESS PLAN

Market analysis

- SWOT Analysis

- **Strengths:** characteristics of the business or project that give it an advantage over others.
- **Weaknesses:** characteristics that place the business or project at a disadvantage relative to others
- **Opportunities:** elements that the project could exploit to its advantage
- **Threats:** elements in the environment that could cause trouble for the business or project

INTERNAL	
Strengths	Weaknesses
<ul style="list-style-type: none"> • Patents • Strong brand name • Good reputation among customers • Cost advantages from proprietary know-how • Access to distribution networks • Exclusive access to specific resources 	<ul style="list-style-type: none"> • Lack of patent protection • Weak brand name • Poor reputation among customers • High cost structure • Definition of distribution channels • Recruiting key technical expertise
EXTERNAL	
Opportunities	Threats
<ul style="list-style-type: none"> • An unfilled customer need • Arrival of new technologies • Loosening of regulations 	<ul style="list-style-type: none"> • Shifts in consumer taste • Emergence of substitute products • New regulations • Increased trade barriers

II. BUSINESS PLAN

TOPICS

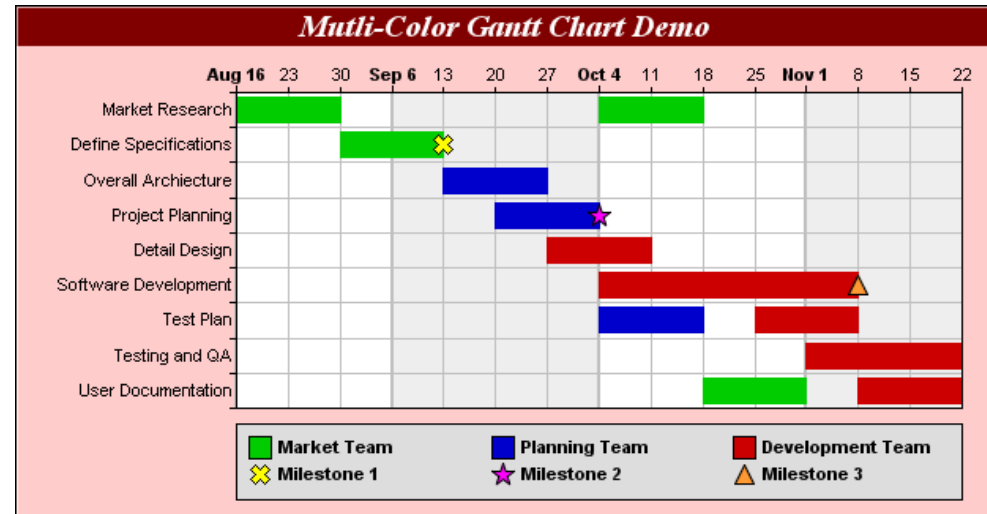
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II. BUSINESS PLAN

Investment objectives and planning

- Objectives
 - Plant
 - Software
 - Buildings
- Activities/tasks
 - Design
 - Preparation
 - Procurement
 - Construction
 - Tests
- Resources
 - Staff
- Timing (Gant diagram)



KEY ACTIVITIES		START	DAYS	TARGET	STATUS	Number of workers	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																												
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II. BUSINESS PLAN

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II. BUSINESS PLAN

Financial planning *(details in Lecture 3)*

- Funding requirements
 - Amount
 - Timing
- Financial projections
 - Sales and costs projections
 - Cash flow
 - Income statement
 - Balance sheet
 - Break-even point
- Financial ratios
 - Activity ratios (Sales growth, Inventories, Current assets/Total assets)
 - Debt ratios (Total Debt/Total Assets)
 - Profitability ratios (ROE, ROA)
 - Liquidity ratios (Liquid assets/Total assets)
 - **!!!** Investment ratios (IRR, NPV, ROI)

http://www.bplans.com/building_construction_business_plan/appendix_fc.php



II. BUSINESS PLAN

TOPICS

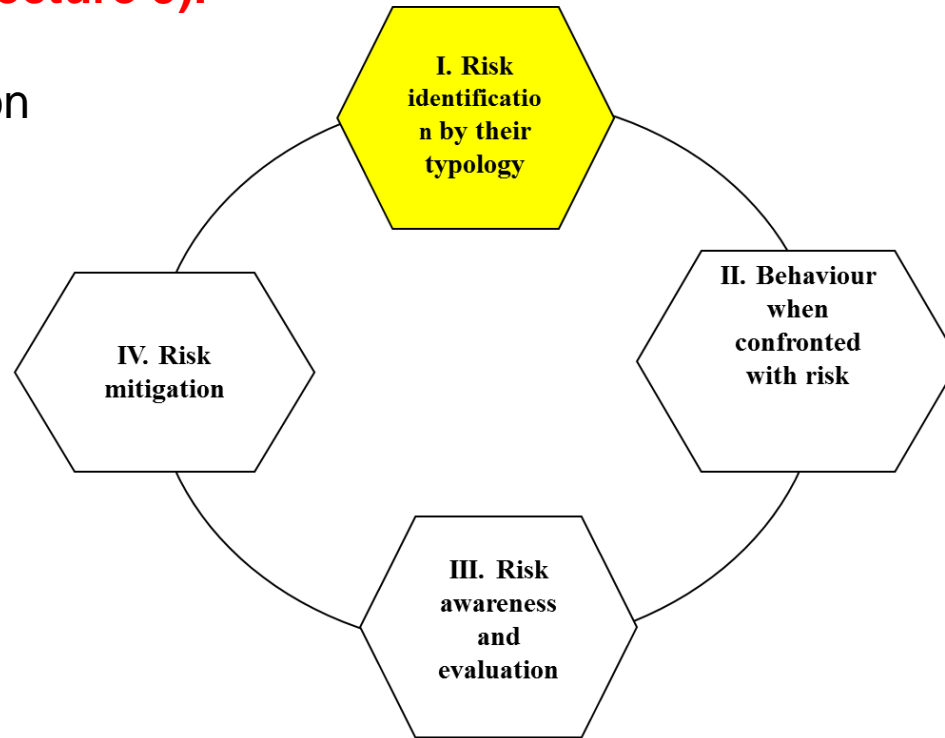
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II. BUSINESS PLAN

Risks (see section I and Lecture 9).

- Risk reduction – mitigation



- Exit strategy
 - sale of equity to someone else
 - mergers and acquisitions
 - downsize operations
 - employee buyouts

III. STRATEGIC PLANNING

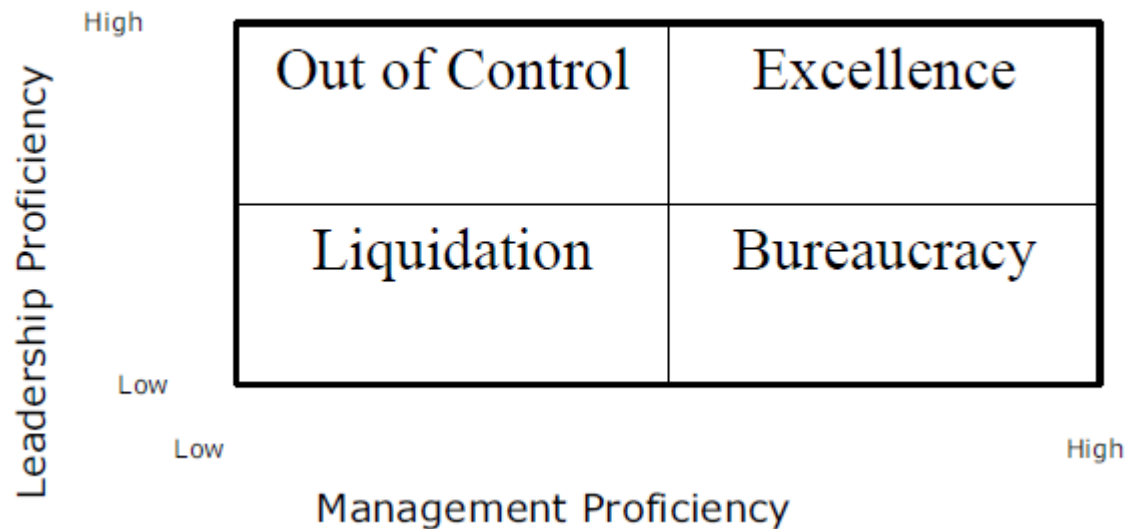
A case for strategy

- Construction: very risky, low profit margins (less than 10% ROI)
 - Success depends on how well it: cope with clients and outperforms competitors
 - Realities: • How do you build something more than jobs? • How do you make better than average profits? • How do you become an enduring, great business???
 - Without planning you depend on luck!
- **Leadership**
 - **Competitive advantages**
 - **Integration**
 - **Strategy examples**
 - **Building Industry Game**

III. STRATEGIC PLANNING

Leadership

- Decisive leadership as a basis for business success
 - Top managers are too immersed in short-term operations
 - Company leaders must establish the business planning



III. STRATEGIC PLANNING

A case for strategy

- **Leadership**
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III. STRATEGIC PLANNING

Competitive advantages

- Commonly **assumed** by contractors
 - Business trades only on price
 - You have to take the market as it comes
 - “Hamster Wheel” syndrome
- Opportunism is **NOT** strategy
 - Strategic planning is not incongruous with entrepreneurialism or opportunism
 - It is the application of more **systematic thinking** to the opportunities that may be available
 - Strategy had better have some bottom-line impact on profitability
 - Direct link between construction business performance and strategy employed



III. STRATEGIC PLANNING

A case for strategy

- **Leadership**
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III. STRATEGIC PLANNING

Integration

Vertical Integration	Horizontal integration
Diversification strategy	Also a diversification strategy
Moving up or down the supply chain	Branching out into other fields that are related to the business
Alternative choices <i>Can the company get more out of its existing market?</i>	The strategy doesn't work well in construction
Matching to existing competencies <i>Is the business a logical fit for existing company strengths, weaknesses and managerial abilities?</i>	Statistically more risky than vertical <i>Almost like starting a completely different business</i>
Impact on current business <i>Will your existing clients now see you as a new competitor?</i>	Make sure it's the right strategic choice for the firm

III. STRATEGIC PLANNING

A case for strategy

- **Leadership**
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III. STRATEGIC PLANNING

Strategy examples

- Grand (High) Strategy
 - macro level direction of the organization
 - sets the overall direction from which the rest of the strategic plans will follow
 - A firm is going to: Expand/Stabilize/Retrench

- Expansion Strategy
 - Only after: demonstrable track record of success; working capital is sufficient to support planned growth; the management team is consolidated
 - Expansion yields inefficiencies and imposes additional costs
 - Sales growth does not necessarily translate into economic growth
 - Increased revenues \neq profit
 - Employee motivation can be a factor
 - Expansion just for the sake of growth is not an effective strategy

III. STRATEGIC PLANNING

Strategy examples

- HOW TO PLAN STRATEGIES?

- Develop comprehensive business plans and communicate company goals and objectives to all employees
- Test a new geographic area with a small project or a repeat customer. Develop a withdrawal plan if the project is not successful.
- Carefully monitor company management capabilities during periods of growth. Learn to recognize signs of inadequate management, and delegate.

- HOW TO IMPLEMENT STRATEGIES

- Develop internal management systems that monitor the status of all projects and provide early warning of problem areas
- Form long-term relationships with industry professionals who can serve as sounding boards and listen to them. Among these specialists are bankers, bonding agents, insurance agents, accountants, and construction attorneys.
- Increase project size gradually. Take on only one larger project at a time. Finish the first larger project and evaluate before taking on the next one.

III. STRATEGIC PLANNING

Strategy examples

- WHAT FINANCIAL STRATEGIES ?

- Understand the **cost of doing business**, and **price** services appropriately sets the overall direction from which the rest of the strategic plans will follow
- Prepare month-to-month **cash flow** budgets each year, and track results monthly
- **Carefully manage company overhead**, and reduce it during periods of declining workload
- Finance equipment purchases with debt to **preserve capital to finance cash flow requirements**
- Purchase a **line of credit as a contingency** to cover unexpected negative cash flows

III. STRATEGIC PLANNING

A case for strategy

- **Leadership**
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III. STRATEGIC PLANNING

Building Industry Game





SUSCOS



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