

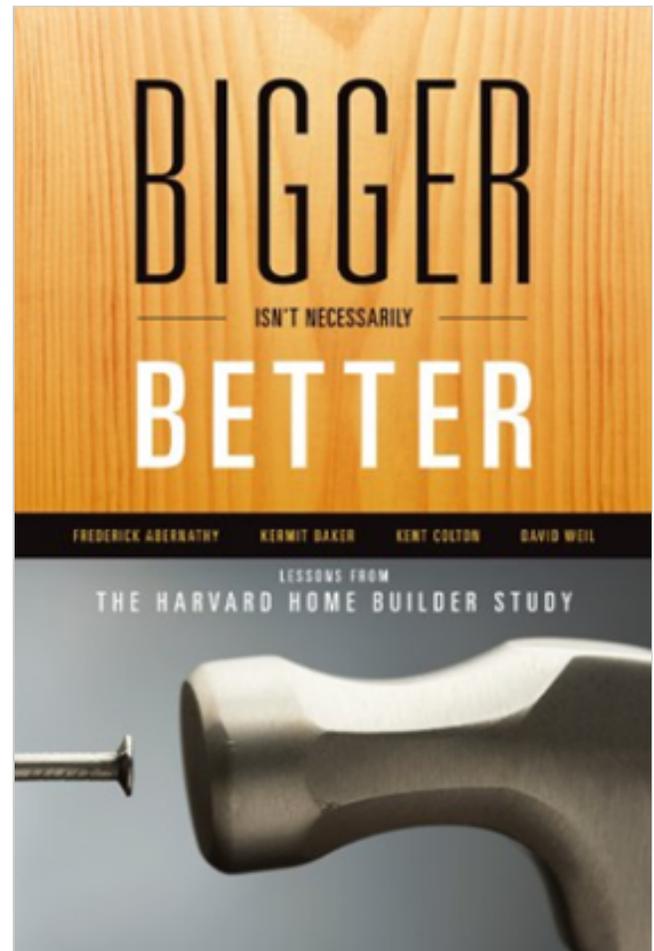
Can “bigger” be a roadblock?

Bigger Isn't Necessarily Better: Lessons from the Harvard Home Builder Study. By Frederick Abernathy, Kermit Baker, Kent Colton, and David Weil. Lexington Books, 2012, 119 pp., \$41.99 paperback.

Choosing a homebuilder is a serious decision. When purchasing a new home, a family entrusts its future safety and comfort to the homebuilder. It seems reasonable to expect that potential buyers would typically start a new home search by visiting the websites of the big-name brands. But why? Possible reasons include associating those big-name brands with good overall quality of construction, excellent customer service, and outstanding home design. *Bigger Isn't Necessarily Better* examines the meaning and impact of being “big.”

The findings of the book are largely based on the Harvard Home Builder Study. Using a detailed survey of homebuilders, this study focused on how economic scale contributed to homebuilder operational performance during the housing boom of 1999–2004. In total, 41 homebuilders participated in the survey: 22 larger builders with minimum sales of 2,500 units in 2004, and 19 smaller builders with 500–2,499 units sold. The survey’s questions addressed areas such as financial performance, supply-chain management, labor and subcontracting, and information and communication technology. The study sought to investigate whether larger residential homebuilders could take advantage of their scale to outperform their smaller competitors in terms of operational efficiency, called “virtuous circle.”

The book illustrates how scale played an important role in contributing to builder profitability. Scale brought large homebuilders significant advantages in three key business functions: securing capital, acquiring land positions, and building a distinctive corporate brand. Because of their larger scale and perceived stability, bigger homebuilders acquired more capital, at lower financing costs, thereby achieving balance-sheet metrics superior to



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those of smaller competitors. Moreover, many of the larger builders went public, a pivotal decision given that equity financing provides companies with a source of capital during uncertain economic times. More solid financial standing enabled the large builders to be more aggressive in land acquisitions, especially in markets with higher appreciation, which was viewed as another key driver of profitability. In terms of customer satisfaction, large builders focused on ensuring consistent customer experiences by standardizing their product options, design requirements, sales protocols, etc. Strong branding also enabled these companies to achieve higher returns by convincing customers to pay a premium for the products they bought. Because of these key operational aspects, being bigger yielded an advantage that translated into profits.

Nearly every builder in the survey used a construction-manager (CM) model. Under this model, builders relied heavily on contractors and subcontractors, employing a very small direct workforce. For instance, direct employees represented less than 5 percent of a builder's major expenses, whereas contractors represented approximately 40 percent of those expenses. This strategy shielded builders from assuming many human-resource costs related to the hiring process, social benefits (such as unemployment insurance and medical insurance), and potential workplace accidents. It also mitigated the impact of layoffs and hiring during seasonal fluctuations in the construction market. Moreover, the widespread use of the CM model imposed higher demands on the onsite coordination and quality control of numerous contractors and subcontractors involved in the residential development of hundreds of homes. Construction costs and construction time were two important dimensions of overall performance. In essence, the quicker the builders could transform an empty lot into a finished home—a mature product that could generate revenue and freeze up building costs—the lower the cost and risk to the builders.

More importantly, the CM model had the significant drawback of creating a potential for inferior workforce quality. It removed the builders from the direct-employer role, leaving contractors and subcontractors in charge of recruiting, compensating, and managing the workforce. The book reveals that, because of price-bidding pressures from the builders and a large pool of workers, subcontractors tended to hire undocumented workers from Mexico, as well as Central and South America, in order to increase profit margins. Around 12.7 percent of the residential construction workers surveyed received compensation below the minimum wage, and about 70.5 percent of those surveyed were asked to work overtime without overtime compensation. The low-wage and low-skill employment strategy could directly affect the quality of construction.

Surprisingly, the survey found that builder performance, measured in terms of costs and construction time, did not improve with builder size, contradicting the “virtuous circle.” According to the book, increased scale did not translate into greater operational efficiency in supply-chain management, particularly in component preassembly and supplier installation. There also was a limited connection between scale and the application of information and communication technology in building-cost estimation and information sharing with suppliers and subcontractors. During 1999–2004, it was acquisitions, rather than organic growth, that drove homebuilder expansion. Consequently, large homebuilders spread out across multiple metropolitan areas with various market conditions (e.g., housing styles, customer preferences, and labor arrangements), using distinct operational practices. The geographically decentralized organizational structure not only complicated the process of implementing standardized operational procedures, but also increased the cost of adopting innovative practices across multiple homebuilder divisions. While riding the rising tide of soaring home prices, large builders put priority on increasing

production volume rather than adopting company-wide operational innovations. Short-term profits supplanted longer term operational efficiencies.

Overall, the book emphasizes the importance of operational innovation—including improvements in onsite coordination, cost savings from suppliers, workforce quality, and the use of information technology—in achieving sustainable financial success. The results reported demonstrate that local market conditions contributed more to such innovation than did sheer builder size. Compared with builders in high-appreciation markets, builders in low-appreciation markets (i.e., areas with lower land costs and lower sales prices) faced weaker gross margins on homes sold during the housing boom. Cost pressures drove operational efficiency and compelled homebuilders to adopt different tactics in low-appreciation markets. It was not striking to learn that builders in low-appreciation markets more readily adopted productivity-enhancing technology (e.g., sharing timely information with suppliers, utilizing computerized estimation). As a result, homebuilder divisions in markets with lower appreciation reported shorter construction-cycle times and lower cost per square foot than did divisions in markets with higher appreciation.

The book excels in applying a quality research methodology to quality data. It is written in a way that is both accessible and interesting. Importantly, it uses various embedded charts and tables that are intuitive and easy to understand. I especially liked the engaging writing style and analytical insights. Although the book does sometimes become repetitive, this does not detract from its overall quality and knowledge imparted. In general, the book is insightful and worth a read, especially for those curious about the home-construction industry or its operation during the recent housing boom.