

GOLIATH vs. DAVID

Presented by:

Charles C. Shinn, Jr., PhD

President

Lee Evans Group / Shinn Consulting

I. Can David (the underdog, the local homebuilder), Dispatch Goliath (the bigger, stronger, more highly rated national homebuilder)?

- A. The top 20 homebuilders will soon produce 75% of all new single-family homes
 - i. Extrapolation of trend data
- B. Most of the increase in market share of the top 100 builders is concentrated in the top 10 builders
 - i. Coming through acquisition
 - ii. Not by expansion of efficient existing operations
 - iii. Growth demanded by Wall Street
 - iv. Average acquired company builds 200 to 500 homes annually
- C. Strong local builders can compete very successfully with national builders
- D. Many new, strong local builders replace those that are acquired

II. The Single Family Homebuilding Industry:

	Builders	% Total S. F. Homes	
Total builders, with starts:	79,100		100%
1 – 24	73,550	93.0%	38.8%
25 to 99	4,340	5.5%	21.3%
100 or more	1,200	1.5%	39.9%

Source: U. S. Census

III. Goliath Is Not The Most Efficient

- A. Supertanker vs. speedboat
 - i. Slow to react to change
 - ii. Must stay in the deep water channel
- B. Bureaucratic instead of entrepreneurial
 - i. Corporate executive
 - ii. Risk averse
 - iii. Can't move fast
 - iv. Not very creative
- C. Excessive layers of management overhead
- D. Must maintain large land inventories
- E. Operating inefficiencies
- F. Difficulty to maintain control of operations
- G. Weaknesses become more acute with every acquisition
- H. Cover inefficiencies with unbridled housing demand
- I. History shows past recessions hit the nationals hard

IV. Goliath Is Losing Talented Key Management Personnel

- A. Turnover is high
 - i. Loyalty is low
 - ii. Make your numbers, or else
- B. Bureaucracy is stifling
- C. Entrepreneurial spirit
 - i. Use high salaries and bonuses to start own company
 - ii. Know Goliath's Achilles Heel
- D. Managers migrating to smaller builders

V. Market Segmentation

- A. Goliath sells undifferentiated product to numerous segments
 - i. Need to cater to the largest market segment
 - ii. Tries to serve multiple market segments
 - 1. Rarely seen as best builder
 - 2. Everything is harder
- B. David can be satisfied with small market segments
 - i. Can be more customer focused
 - ii. Better customer research on target niche
 - iii. Design product and services for target customer
 - 1. Truly the expert among potential customers
 - 2. Can become the best in one or two customer niches
 - 3. Target marketing
 - iv. Simpler to stay focused
 - v. Highly profitable

VI. Cost of Capital

- A. Cost of capital for Goliath may be less
 - i. Cost of capital for Goliath's local operation is comparable, or higher
 - ii. Short term focus on fund allocations
- B. David's cost of capital is from local bank financing
 - i. Large number of local sources competing for business
 - ii. Self-financing
 - iii. Owner financing with construction / perms
 - iv. Exposed to interest rate risk

VII. Land Acquisition

- A. Goliath has large pockets
 - i. Can out bid David
 - ii. Purchases large land parcels
 - iii. Maintains large inventory of land
 - iv. Often pays too much for land
- B. David has local knowledge
 - i. Better insider information
 - ii. Better relationships with land owners
 - 1. Has first opportunity to purchase

- 2. Can tailor acquisition for seller needs
- iii. Has an advantage of speed
- iv. Smaller infill land parcels
- C. Large master-planned community developers
 - i. Favor small builders for diversity of homes
 - 1. Multiple market segments served
 - 2. Greater lot absorption

VIII. Dealing With Municipalities, City Councils And Planning Commissions

- A. Goliath has a hard time adapting to local requirements
 - i. Strong-arm tactics
 - ii. Perceived as an outsider
- B. David has local knowledge
 - i. Knows political landscape
 - ii. Perceived as part of the community
 - iii. Can adapt to local requirements

IX. Purchasing Power

- A. Is the purchasing power of Goliath a myth?
 - i. Negotiate manufacturer rebates
 - ii. Negotiate volume discounts with vendors and trades
 - iii. Product allocation protections
 - iv. Still not getting best price
 - v. Strained relationship
 - 1. “My way or the highway”
 - 2. Lack of loyalty
 - 3. Impersonal
 - 4. Difficult pay process
 - vi. Job sites are not efficient
 - 1. Unreliable schedules
 - 2. Dry runs
 - 3. Multiple trips
 - 4. Messy job sites
 - 5. End of quarter and year rushes
- B. Small builder consistently buying as good or better
 - i. Develop buying cooperatives
 - 1. Manufacturer rebates
 - 2. Volume discounts
 - ii. Develop strong relationship with vendors and trades
 - 1. More loyal to vendors and trades
 - 2. Trade councils
 - 3. True partnering
 - a. Strong long-term relationships
 - b. Two way street
 - iii. Better organized job sites
 - 1. Reliable schedules

- 2. Reduced dry runs
- 3. Clean sites
- 4. No end of year push
- iv. Implementing field technology
 - 1. Central schedule notification
 - 2. Extranet
 - 3. Handhelds
 - 4. Tablets
- v. “The employers of choice”
 - 1. Get the best trades
 - 2. Lower price
 - a. Trade more profitable

X. Cost of Construction

- A. Generally comparable for Goliath and David
- B. Many small builders have become very efficient
 - i. Direct construction cost as low as 35% of sales price
 - ii. True value engineering
 - iii. Understand customer perceived value
 - iv. Mass customization instead of semi-custom

XI. Quality

- A. Goliaths compete for J. D. Powers Award
 - i. Customer still dissatisfied with quality
 - 1. Product
 - 2. Service
 - ii. Impersonal
 - 1. Lost in system
 - iii. House not finished at closing
 - 1. Rush to close
 - iv. Improve performance
- B. David has been doing a better job
 - i. Meet and exceed target customers expectations
 - ii. Implement customer friendly systems and procedures
 - iii. Personal touch
 - iv. Quality control programs
 - 1. Build it right, the first time
 - 2. Scopes of work and checklists for trade contractors
 - 3. Several quality inspections during construction
 - 4. Final internal quality inspections
 - 5. Proactive warranty and customer service

XII. Real Estate Markets Are Local

- A. David probably has an edge in most markets
- B. Customers want to deal with a local builder

- C. Branding
 - i. Needs to stand for something
 - ii. Small builder tends to have the edge

XIII. Well-Run Small Volume Builders Are Thriving

- A. 2005 Shinn Consulting / Lee Evans Group Financial Study
 - i. Homebuilding profit, not including land:
 - 1. Average – 10.24%
 - 2. Over 15% net profit – 16.5% of participants
 - 3. Over 30% net profit – 4.0% of participants
 - 4. Highest result was 43% net profit