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Three Bids and a Cloud of Dust

Increasing Profitability through Supply Chain Control

By Tom Harper

Not one analyst, reporter, economist or builder will tell you that the snapshot of today's housing market is prettier than that of years past. Housing starts have slowed, land prices have increased, interest rates are rising and employment rates are declining. However, the bursting bubble may represent a fountain of opportunity for builders.

As the market slows, and market share shifts to larger builders, smaller builders must look to their operational practices and cost structures to maintain or increase their competitive advantage.

The key is to take advantage of the slowing market to re-establish sound business practices and utilize new technologies to manage costs and increase margin.

Essentially, it's a move 'back to the basics', to the foundation. The foundation in this case, is not made of poured concrete, but sound information related to the fundamentals of your business – material expenditures, purchasing, labor and indirect costs.

Once information is gathered – the foundation is poured -- the building may begin. What are the materials you will need to build your sound business practices? Today there are new tools available for managing materials costs, and tried and true measures that can be reinstated to increase efficiency. They include; (1) sound purchasing practices, (2) utilization of technology, (3) cost containment measures as related to supply chain efficiencies, and (4) back-end savings opportunities.

1. SOUND PURCHASING PRACTICES

Material costs can make up nearly 30 percent of the overall cost of production on a new home build. Consider this: if an average savings was achieved -- four percent -- it would result in a savings of \$396 million across the U.S. residential homebuilding industry. This translates into a savings of nearly \$3300 per home – substantial to any size builder.

But these savings can only be achieved through sound purchasing practices.

The use of Material Take-off's (MTO's) and Bills of Materials (BOM) are not new, yet during the boom many of these practices were abandoned due to high volume – builders didn't need to contain costs as housing starts and pricing power rose exponentially. If a builder maintained a staff of estimators, their role was greatly diminished or eliminated during the recent good times.

So, purchasing practices became "three bids and a cloud of dust." Suppliers or subcontractors controlled prices, and builders accepted their decreased power over the process.

But by utilizing accurate MTO/BOM's a builder gains information that puts power back into their hands and keeps them ahead of the bidding process. In some cases, accurate materials information allows the builder to remove layers from the supply chain – the ability to go directly to the distributor for materials, for instance – wringing often significant savings from a project.

2. UTILIZATION OF TECHNOLOGY TO MANAGE MATERIAL TAKE-OFFS (MTO) AND BILLS OF MATERIALS (BOM):

While accurate estimating is not a new practice, estimating technology is a relatively new tool – one that cuts time and provides data that has long-term use.

By implementing software that tracks materials electronically, a three-step process becomes one simple step – saving time and money. The home plan is digitized and converted into the MTO/BOM and bid forms. The electronic bid form becomes the key to managing the purchasing of the project – and negotiating price when approaching suppliers or subcontractors.

The end result is more negotiating power, less waste, and the exact purchasing information needed to streamline operations.

Additionally, digitizing the materials planning process results in a plan library that provides a real-time pricing catalog and can be utilized in future projects that speed up the bid process.

Of course, "garbage in equals garbage out". Despite the power of technology, construction and purchasing experience is critical for total accuracy in materials planning. We recommend supplementing technology with an old-fashioned site walk by an experienced estimator or member of the building team to validate data impacting the MTO.

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3. COST CONTAINMENT

The building supply chain is complex – materials change hands up to five times in an average home -- from manufacturer to wholesaler, to distributor, through the trades and finally to the home. These layers of suppliers also add layers of cost.

By understanding material costs through the estimating process builders become less dependent on their specific channel partners and can find cost savings as a result.

The savings are most apparent from volume buying. In the “three bids and a cloud of dust” model, builders rely on trades not only to estimate the MTO for a home, but also to manage buying for a specific product.

However, a homebuilder may use several trades to handle his yearly build volume. By allowing subcontractors to make estimating decisions, they are at the mercy of the subcontractor’s pricing, but also relinquishing possible volume buying power.

For example, if a builder uses four plumbing subcontractors to build 200 homes in a year, the pricing for material may be much higher, as each subcontractor is purchasing only what they need to fulfill their portion of the overall volume. With a better understanding of their overall material needs, these purchases can be made from one supplier, gaining better spend leverage through volume buying.

4. BACK-END OPPORTUNITIES

The final opportunity for builders to maintain costs is through back-end opportunities such as rebate management.

As it stands today two-thirds of builders who participate in rebate programs don’t believe they are collecting all the rebates to which they are entitled. They are right. “Big Builder,” in a recent issue, noted that \$1.1 billion is lost every year through poorly managed or uncollected rebates.

This can mean savings of hundreds of dollars per home, which can easily increase margins and is easy to accomplish -- through MTO/BOM’s. The digitized plan discussed above also gives the builder greater control over information related to the use manufacturer’s products. Additionally, once the plan is digitized software is available to compare the products used with the rebate dollars offered. Rebates can be claimed more easily and tracked year to year, which can also affect buying decisions.

So, while builders may struggle to regain profitability in a slowing market, opportunities are present for cutting costs and building margin through careful management of materials, costs, and the supply chain.