



THOUGHTS ON STRATEGY
**LEARNING FROM THE
SAGES AND SURVIVORS**

A SAMPLING OF INDUSTRY WISDOM AND SAGE ADVICE
FROM SEASONED HOME BUILDING PROS

By Scott Sedam, Contributing Editor



Is there any business topic covered more often than “business strategy”? Just for fun, I entered that term on Amazon.com in the “books” subcategory and got more than 40,000 results. Next, I refined my search by clicking “four stars & above” for the average customer

review, limiting the results to only the highest-rated books, and that still turned up more than 10,000 items. Incredible!

Where do we start? In its most basic definition, strategy is simply a set of plans to achieve a goal. So how does this topic get so complicated that tens of thousands of people—including yours truly—are compelled to sit down, write about it, and then go to the trouble to get those ideas published? I believe it’s because most of us are fascinated to watch and learn how people create a mental plan for a business using a variety of resources and then convert that plan into tangible results—or not. I heard a statistic on the radio just yesterday that more than 90 percent of startup companies fail within 18 months, which makes learning about the successful ones even more compelling.

At *Professional Builder’s* recent 40 Under 40 conference at PCBC in San Francisco, I presented on “12 Things I Wish I Knew About Home Building Before I Turned 40,” based on the column of the same title that ran in last month’s issue of *Pro Builder*. Additionally, I told the participants I’d send the column out to a group of industry “gray hairs” to see what they had to offer on the topic.

The response from my senior compatriots surprised me. I received a wealth of material on a wide variety of subjects, some of which I’ll share here. It seems these sages and survivors—all very successful—learned a lot during their later years that they wished they’d known earlier.

I found the feedback naturally fell into certain groupings. Some of the most interesting came together under the heading, “Strategy, Marketing, and Product,” which essentially boils down to understanding what product and/or process we are taking to market, for whom, and how.

OPERATING PLANS AND WHAT HAPPENS AFTER LAND PURCHASE

STEPHEN BROOKS, CEO of Grand Homes, in Addison, Texas, began his advice simply: “Strategy is more than knowing where you are going; it’s how you get there by having well-defined operating plans.” He then added this ominous warning: “The day you buy the land is the day you either succeed or fail.”

Having known Stephen for years, I can tell you he and his team put incredible effort into the details after land purchase.

He acknowledged this by adding: “Architectural style and design trump everything, and value engineering is absolutely essential to your success.” Essentially, Stephen is saying it’s hard to fail on a great piece of land at the right price, but it’s easy to fail on a lousy land purchase. Yet, he warns that even a great land buy in the best location will underproduce with marginal design and high cost.

Of course, it gets more complicated. Todd Booze, president of construction at Ideal Homes, in Oklahoma City, Okla., describes it this way: “Stay focused on what you do well and what your people can execute flawlessly. Too many times, we’ve tried to make something work because we felt like we had the ‘Golden Touch’ only to later realize that not all market segments or niches can be handled with the current team and/or culture.” Todd is right, and the best builders have that understanding front and center before they consider any land purchase and what they’ll build on it.

THINKING COUNTERINTUITIVELY AND LEVELS OF RISK

BOB GOODALL, president of Goodall Homes, in Nashville and Knoxville, Tenn., a division of Clayton Homes, a Berkshire Hathaway company, and a former Professional Builder Builder of the Year, was among the most successful builders in the U.S. during the brutal housing downturn, with significant growth and market share gains. How did he manage that? “You have to be counterintuitive,” he says.

According to Bob, “What goes up must come down, and what goes down must come up. Recognize that the housing industry runs in cycles. We are all human, and emotions lead us to run with the herd. The market gets hot and everyone’s euphoric; the market goes bad and everyone runs for the hills. Think differently from the herd, buy when others are selling, and sell when others are buying. Warren Buffett says, ‘... try to be fearful when others are greedy and greedy only when others are fearful.’” Some may say that sounds risky, but Goodall and Buffett believe the opposite.

Dave McArthur, cofounder and retired president of McArthur Homes, in South Jordan, Utah, has some advice when it comes to risk: “Be addicted to low risk. If you use debt to hold land, develop lots, and build homes, the question is not if you will go out of business but *when*. When things heat up, buying land to ‘feed the machine’ is pointless. When things turn, you still have to let people go and pay interest on overpriced land. Better to have cash in the bank, carry the overhead if you choose, or let folks go when the economy improves. At least then they are looking in a better job market.

Especially in a downturn, it's better to make the next dollar than to squeeze the last penny out of the current one."

John Burns, president of John Burns Real Estate Consulting, has watched the industry for decades and translates the debt question into personal terms, "Debt equals risk. Companies can grow fastest by borrowing a lot of money. This can make people rich, and it can also force them into bankruptcy—all within the same decade. Decide the level of risk you are comfortable with, and always understand how much risk your employer is taking. And be sure you and your spouse are aligned with the level of risk you are taking at work, too."

LESS IS MORE AND REVERSE ENGINEERING

MIKE BECKETT, chief product developer for Brookfield Residential Texas, in Austin, is both highly passionate and very practical, always thinking in terms of implementation and strategy. He sent this warning: "Strategy is not a [expletive deleted] shotgun! It's a rifle shot and it needs to be exact." Mike adds, "Less is more today. Quit throwing in so many standard features. Know your buyer. If you ask your salespeople to individually list the top five items in your homes, you get completely different lists, yet the customer is the same. Maybe they appreciate two of the five items?"

Getting down to execution, Mike adds, "With good design, we can build essentially the same house, less 200 square feet, and greatly reduce labor and materials. Reverse engineer from your pro forma budget and don't give up. Things are going to slip on cost over the product development cycle—consider lumber in 2018—so you have to hit the mark." I've watched Mike do this and he's the real deal. He ended his note to me saying, "Strategy is to concentrate on something epic. Deliver well and you can beat the market!"

THE IMPORTANCE OF RESEARCH

DWIGHT SANDLIN, CEO of Signature Homes, in Birmingham, Ala., and Huntsville and Nashville, Tenn., offers a practical, step-by-step approach to determine if this epic product of yours will actually sell. "Market research is paramount, but that doesn't mean you need a \$50,000 study for every project. For each community, we do our own research. With the online resources available today, the process is simple." His process:

1. Establish a realistic retail price, taking into consideration the market and your current costs, before signing the contract to buy the land or lot. Lot cost is the driver.

2. Look at all sales in the market, considering both new and existing homes. New homes typically account for just 10 to 12 percent, so know what your potential customer is looking for.

3. Project the sales absorption pace from \$25K below to \$25K above your retail sales price to gauge the sales per month in this area, both new and existing.

4. Look at the number of homes on the market to establish the months of inventory.

5. Look at pending sales to see what has sold but not closed.

6. Be realistic. If the market is weak, don't assume you can build a better home than your competition.

7. Recognize unmet needs. If the market is strong, look specifically at the homes sold, pending, and available, then determine how to provide what is not currently being built in the market.

Dwight sums it up this way: "The real challenge is to think like a purchaser when you are doing the analysis. Spend as much time as needed to understand. Don't wait until your home is complete and wish you'd done something different."

MARKETING, ADVERTISING, AND SALES AS DISTINCT CONCEPTS

JIM WALDROP, former Pulte Homes division president, as well as founder and former CEO of home building rebate management company HomeSphere, calls out the practical distinctions between marketing, advertising, and sales and how they relate to strategy: "All too often, business leaders throw these terms around as if they're one and the same. Not true." He outlines the distinctions:

Marketing is the process of moving products and services from concept—that is, product design—to the customer by satisfying the customer's needs. Market research is an essential component in determining what the market needs, and it includes thorough blind-shopping, not merely "walking" the competitors' product.

Advertising calls the public's attention to the availability of those products or services.

Sales is the set of activities enabling the potential customer to become a buyer of the seller's product or service.

Jim concludes: "Marketing, in this context, serves as the strategic plan to drive the set of advertising and selling activities. Builders that use these activities to design the right product with the right price at the right time are the ones that have high absorption rates—even in difficult economic conditions."

THE DUPONT EQUATION

GEORGE CASEY has run multiple builders in a long and storied career: To say he has been around is an understatement. In his current role as CEO of the consultancy Stockbridge Associates, George looks back and points to one specific business formula he'd like to have understood earlier: "I wish I knew how to

apply the DuPont Equation to home building operations to drive improvement before I was 40," George says. "The DuPont Equation calculates the most important intersection of the income statement and the balance sheet of an enterprise. It is stated as EBITDA/Assets, or the unleveraged Return on Assets that a business drives. Think of it as the equivalent of the yield on a certificate of deposit—the higher the better." George outlines the DuPont Equation's three components that interact with one another:

EBITDA/Gross Profit: This is how much of your gross profit makes it to the bottom line and through the "friction" of overhead. Getting far past the breakeven point is the key.

Gross Profit/Cost of Goods Sold: This is a measure of the incremental value (Gross Profit) you generate compared with cost of bricks, sticks, and land (Cost of Goods Sold). Focusing on great design, purchasing, execution, simplicity, variance control, and customer relationships will drive this higher.

Cost of Goods Sold/Assets: This is how many times you can use and reuse your capital each year. Its key drivers are production cycle time and how much "dead" inventory, mostly land, you hold. Continually reducing cycle time and aggressively managing dead land are key strategies here.

George concludes: "Focus on strategies that meaningfully improve each of these components and, as if by magic, your return on assets will improve. Making sure that EBITDA/Assets is higher than your costs of capital is critical. If it is, you're doing great. If it's not, you are slowly bleeding away your net worth. The logic of the DuPont Equation applies to businesses of all types. It's probably the most meaningful technique for you to have in your kit bag to succeed in business financially."

BUSINESS EVOLUTION AND STAYING CURRENT

DAVE ERICKSON, president of Grayhawk Homes, in Columbus, Ga., is someone who thinks deeply about the business and what works, having beaten back continual challenges from outside builders entering his market over the years. Dave begins with a simple declaration: "Business is about delivering a service or product. You get paid to deliver that product to meet someone's needs, whether that's an individual or an institution. Understand that the product—house—you deliver today may not be the product you need to deliver next year—tastes change, demographics of families change, lifestyles change. Each change requires a response; a modification to your product from what you build today."

Dave continues, covering a lot of ground: "The same goes for your business as a whole. In my 25-year career, I've had to radically evolve my business three times to adapt ... The first

time, in 1993, was creating the business to take advantage of the assets the community had to offer. The second time was in 2008 to evolve with the Great Recession. New trades were available, new plans were necessary, and we needed new approaches to what to build and how to build in a different financial environment. Trusses, PEX piping, a new accounting system, etc. None of these were acceptable in the 'old' economy. Now they were available and optimal. We made all of these changes on-the-fly in a three-month time line from launch and we stayed profitable the entire time and were stronger in the long run.

"The third time was evolving out of the recession, early in the cycle in 2011. In a short period, we realized the world had changed again and we also made significant changes, although they were a bit less radical than round two. It was all hands on deck and do it now, creating a different product to face the evolving competition. We succeeded in beating back the new invaders and have gone on to continued success, constantly making small iterations of change as necessary. Today we're on the cusp of another sizable change: Labor and evolving interest rates are pushing us in a new direction. What was working before is less effective today. The market is still good, just different. Our job is to identify it and evolve with the times."

That wasn't all Dave Erickson sent me. I told him he should write a book. His experience vividly demonstrates how business strategy must change and evolve when the market changes. That is exhausting just to think about, but George Hess, CEO of Vantage Homes, in Colorado Springs, Colo., sent this lesson, which wraps it all up nicely with a simple admonition that few treatises on strategy would include: "This is a *relationship* business. We have done more lot deals because of relationships than we ever did because we were a good builder. The latter matters, but the first is all-important. We're in the People Business."

SO MANY POSSIBILITIES

This has been a bit of a Sherwin-Williams "Cover-the-Earth" approach to the topic of strategy. That was my intent, to show just how far-reaching this simple-sounding idea of creating a plan to convert a variety of resources into tangible results really is. These successful sages and survivors in home building have shown you where to start, what to consider, and how to think about strategy, and their input is acknowledged and appreciated. The rest is up to you. **PB**

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