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TEXAS: Lessons from the Lone Star State

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Texas: Lessons from the Lone Star State

By Chris Daum

This edition of "The Quarterly" is all about Texas, the Lone Star State.

Many of the trends and market conditions in Texas reflect the broader national picture—which is not surprising, since the state's $1.65 trillion economy is the second-largest state economy in the U.S. Or said differently, it's almost the size of Brazil's economy (GDP of $1.77 trillion in 2015).

With an economy of that size and complexity, there are numerous lessons that engineering and construction firms can draw from Texas and then apply to a broader scale.

Consider this: Since 2011, Texas has outgrown other states by nearly a 3-to-1 margin and with a 26% compound annual growth rate. On an overall basis, Texas is the largest market for private, nonresidential construction put in place (CPIP).

Much of this growth and economic expansion can be attributed to the state's founding principles: Texas is driven by a pro-business attitude and entrepreneurial spirit that translate into every aspect of the engineering and construction industry. The state also has a favorable regulatory environment, low taxes, a multicultural workforce and an incredibly diverse economy. So, while there's no question that Texas is "really big," the single greatest lesson we can learn about the state is: "Texas just works."

Texas companies that thrive are the ones that truly embrace the local microcultures where they're located. For example, if you want to do business in Houston, you have to have a physical presence in Houston; you have to think and act locally. Accordingly, each of the country's top-10 contractors has significant operations in the Houston metro area, and a quarter of the region's largest contractors have regional or national headquarters there.

Even if your plans don't call for relocating or doing business in the state of Texas, there are things you can learn by studying this state's market. These principles are equally applicable in your own local market and include embracing an entrepreneurial spirit, thinking big, acting fast, embracing diversity beyond what's in the four walls of your own organization, and seeking out strategic partnerships.

In this Quarterly edition, our authors describe Texas' business climate and reasons for success, share important lessons learned, and explore some of the key reasons why this state has maintained its prominence in the business market for decades. With its clear cultural and market sector diversity, Texas can teach the rest of us a thing or two about how to apply those success principles industrywide—regardless of geographic location.

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What E&C Companies Can Learn From the Texas Model

By Candance Hernandez and Pat Kiley

Built on four key pillars of strength, Texas parallels the engineering and construction industry as a strong, vibrant component of the U.S. economy.

"The secret's in the dirt." Uttered by legendary golfer Ben Hogan about how he developed his winning swing, that statement also very accurately describes the foundation of Texas' continuing prosperity since winning independence from Mexico in 1836 (and then joining the U.S. as the 28th state in 1845).

Texas' dirt has always been its destiny, and there's a lot of it—268,597 square miles, to be exact. This massive land has sequentially supported thriving industries in cattle, cotton and crude—all industries that are both vibrant and growing. The state leads the nation in the cattle business (with 11.8 million head), the cotton business (producing over 45% of American output), and the crude oil production business (with roughly 3 million barrels per day, thanks to the deep reserves in the Eagle Ford and Permian Basin shale fields).

The state's abundant resources have provided ample opportunities for companies to create fame and fortune over the years. However, all three of these basic industries are tough and "dirty" and require the dedication of rugged, courageous, optimistic entrepreneurs who are willing to make big front-end investments for long-term returns. To be successful, these people have to be confident in their ability to manage the risks of weather, unknown conditions, bad data and—as in the case of cattle and cotton—disease. As such, these industry pioneers are kindred spirits to contractors. The businesses these industry pioneers launched became magnets for people who were seeking a better life for their families and/or freedom from tyrannical governments—a trend that continues today.

Texas' Four Pillars of Strength

Texans admire the grit and the guts that entire communities of Czechs, Germans, Norwegians, Irish, Italians and Mexicans (to name a few) showed in the early 1900s when some walked hundreds of miles and took unfathomable risks to become citizens of their state. These immigrants were (and continue to be) welcomed and appreciated. For example, most Texas construction company leaders are vigorously supporting comprehensive immigration reform that will give these determined workers legal status to remain. Texas' character, culture and continuing success were born in this alchemy of a new state, which offered new opportunities and attracted diverse, independent, rock-solid people who learned how to live and work together. Those qualities are alive and tangible yet today.

This environment predictably unleashed an absolute bonanza for construction companies. These budding businesses needed facilities, and the migrating people needed homes. Large cities began to emerge primarily as hubs to support the specific industries: Fort Worth (cattle), Dallas (cotton) and Houston (oil). The business infrastructure began expanding too, and rail and telegraph were critical to all three industries. The banking, manufacturing and law industries began to take root, as did specialized services for each nascent industry. At the same time, the massive Texas highway system was built. And human infrastructure soon followed, comprising utilities, schools, churches, hospitals, hotels and services provided by the cities (i.e., police, fire, water, sewer, streets, bridges, waste removal, etc.).

So what makes Texas such a great state for business, year in and year out? And what are the values that form its culture and drive its prosperity? Research reveals the foundation for its success is built on four pillars.

1. **Texas has a declared vision**, articulated by then-Gov. George W. Bush, to be a "beacon for business." Texans want businesses to start, stay and thrive in their state. Thus, the state has a minimalist attitude toward regulations and taxes. It has no state income tax, it is a right-to-work state, and it has at-will employment. Construction employment is over 90% nonunion. When an issue arises that is harmful to companies, business leaders respond quickly and forcefully. In the mid-1990s, Texas was becoming known as "the lawsuit capital of the world." The TV program "60 Minutes" covered the trend, Time magazine published an article on it, some businesses considered leaving the state, and certain communities could not find new physicians. Three businessmen, one being the late Leo Linbeck (a commercial building contractor), formed Texans for Lawsuit Reform and achieved comprehensive reforms to the tort laws. The organization's grass-roots approach became a national model.

2. **The state retains its entrepreneurial soul** and reveres the committed risk-taker. Individuals who have great ideas will get funded in Texas. It does not matter who their family is, "what their daddy did," or where they went to school. If they have an idea and are willing to go all in themselves, they will find backers. But they better be doers, not talkers. Texans, like contractors, value authenticity. The worst insult a Texan can give is, "that person is all hat and no cattle," meaning a person needs to walk the talk.

3. **There is pervasive optimism in Texas,** and that optimism is often combined with big, expansive thinking. Much like construction, the state's three foundational industries (cotton, cattle and oil) require inherent optimism that reflects an understated confidence, not braggadocio. Ranchers must be congenital optimists to breed, raise and sell cattle, believing they will get a price at the end of the year that makes all their efforts profitable. The same is true of the cotton farmers, while the oil business requires even more optimism and perseverance. A person must believe there is oil under the ground, at the bottom of the ocean or in those shale rock formations—and have an unwavering belief that his or her efforts will pay off someday.

   Patillo Higgins, a self-declared geologist who had failed twice in other businesses and who had one of his arms shot off by the police, believed there was oil under the large salt dome near Beaumont. No one else bought into his theory, with the naysayers including trained and respected geologists and investors. Undeterred, Higgins paired up with retired Croatian Navy captain and former salt miner Anthony Lucas. An investor who would later cut him out of the deal, Lucas worked with Higgins in 1901 to insert a rebuilt drill bit into a pipe now 1,020 feet underground. They heard gurgling sounds, then a noise like a cannon shot, and saw the drill pipe shoot out. They then watched oil gush 150 feet into the air. "Mighty Spindletop" roared into existence, producing 100,000 barrels per day, more than all other wells in the U.S. combined. Over 100 companies were born because of this discovery, including Gulf Oil, Amoco and Humble Oil (now Exxon).

4. **Texas has a commitment to embracing and celebrating diversity.** Since its earliest days, the state has been a melting pot of many races, nationalities and religions. The international companies and medical institutions headquartered in Texas have recruited and hired the best minds from all over the world, elevating and enhancing the international flavor of the major cities. Houston is the most racially and ethnically diverse city; this decade Texas became one of only a handful of U.S. "minority-majority" states. Many of these immigrants have an entrepreneurial bent. They start businesses, attract growth capital, prosper and give back to the community through philanthropy and service—it's a virtuous cycle. This comfort with differences is just an extension of the entrepreneurial culture of the state. Dreamers who are also doers are always welcome, no matter their roots.

How to Sprinkle a Bit of Texas Into Your Business

The qualities that work together to make Texas such a consistent success story have also generated strong results for engineering and construction firms. There is an impressive number of Texas-based firms representing all market segments. Many of them are now over 100 years old. Austin Industries, Bellows and Tellepsen have all found success in the vertical construction market for over a century. Others like Dean Word Company and Heldenfels Enterprises have established themselves in the highway markets. The firms between 50 and 100 years old are too numerous to name, and many were founded by veterans of WWI or WWII. Other companies with long histories that have opened offices in Texas and thrived include McCarthy, Gilbane and Chamberlin Roofing and Waterproofing, to name a few.

What has made these companies so successful in Texas? These firms have, first and foremost, a clearly articulated vision, a compelling picture of their desired future. And while that picture may not ever be truly attainable, it is both highly desirable and believable. This is a proven best practice; many of the most heralded companies in the world have inspiring visions.

Additionally, these firms epitomize the pillars of strength mentioned above, particularly in terms of the retention of the entrepreneurial soul and pervasive optimism. These qualities integrate rather naturally and are highly visible in long-lasting engineering and construction companies that serve mature, cyclical and increasingly volatile markets. Survivors not only adapt and change, but they also reinvent themselves to seize new opportunities, no matter how big, or procedure- and process-oriented, they become. Their leaders relish taking new risks to gain market share and grow. These firms stay agile and opportunistic. They are giants who can dance, to paraphrase Harvard author Rosabeth Moss Kanter.

Another critical characteristic of these highly adaptable companies is their core ideology. The combination of a strong core purpose and solid core values has supported these companies' envisioned future and remained unchanged over time. These sacred principles were their reliable "true north"—their indestructible foundation that allowed them freedom to take new risks and change. Their leaders were strategic over many generations and reinforced the old business maxim, "Modify form, preserve substance, know the difference."

Firms that moved to Texas and achieved the highest levels of success came with no preconceptions that they are better than the local firms. Embracing the "Texas Way," engaging within their local communities and leaving their egos at the door served these firms well. Texans want to see the big front-end investment that proves your company is serious about Texas and that it's not just a drifter looking to make a quick buck on a trophy project. Acting local brings a warm welcome; acting superior brings a swift boot.

Finally, there is increasingly visible evidence of real and deliberate diversity in these firms. The VUCA (Volatility, Uncertainty, Complexity and Ambiguity) environment requires very bright people with critical competencies, often not available from traditional hiring sources. Smart, data-driven leaders are studying and emulating high-performing companies (i.e., the technology leaders, which are global melting pots). Texas itself is a melting pot, with no clear ethnic majority. As a result, diversity is blossoming by gender, race, age, educational background and country of origin in many Texas E&C companies.

Historically, what has been good for Texas is good for business. By ensuring these pillars are a part of your company culture, you will maximize your success in the Lone Star State—and everywhere else too.

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Texas Does It Right—
Workforce Development Initiatives

By Dustin Bass and Sabine Hoover

Three workforce development experts from Texas share their thoughts on how the E&C industry can do a better job of developing the workforce of the future.

A major concern for engineering and construction (E&C) firms across the U.S., the skilled labor shortage, has employers struggling to staff their projects. "If the economy stays strong and there's continued investment in infrastructure, I don't see the shortage going away," Sue Klawans of the Gilbane Building Company told "Construction Dive."

This trend is lingering after a large segment of the construction workforce was forced to leave the industry for other jobs when their work disappeared during the Great Recession, the magazine reports. In fact, between April 2006 and January 2011, the construction industry eliminated more than 40% of its workforce, cutting nearly 2.3 million jobs.[1]

Unfortunately, a high number of those workers have yet to re-enter the field, having moved on to other jobs, industries and opportunities. To learn some of the best practices that E&C firms can use to work through these issues and accommodate their growing project backlogs, three Texas-based workforce development strategy experts shared their top strategies for success.

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[1] Where did all the construction workers go. WSJ Blog. June 9, 2015.

Building New Career-Development Volunteers

At a microeconomic level, the shale revolution has been positively impacting the Gulf Coast's chemical industry for about seven years. According to Chad Burke, president and CEO of the Economic Alliance Houston Port Region, "With all the tens of billions of dollars of capital investment in the chemical industry (because of low-cost feed stock in natural gas), a lot of great things are happening here."

Rewind the clock about 20 years, and the landscape along the Gulf Coast—and especially in Houston—was remarkably different. Growth in the domestic chemical industry was slow, namely because other regions of the world had access to lower-cost feed stocks. "There wasn't a need for a lot of new blood," says Burke, "or new workforce development." For years, in fact, as individuals retired out of the industry, there wasn't a great need to backfill with younger employees. This created a vacuum or growing gap in experienced skilled employees in the local chemical industry.

"That dynamic was percolating under the surface," says Burke. In 2010 fracking technology gains began to produce low-cost domestic natural gas, which attracted significant investments in the petrochemical industry in the United States. Burke recalls hearing some rumblings from the industry about workforce development back in the 2010-2012 time frame, but says the fact that many baby boomers delayed retirement (due to the recession, mainly) "put a Band-Aid or hold on it for a few years."

Four years ago those rumblings got a little louder. "It became apparent that something had to be done," says Burke. Intent on making Houston the most competitive region on the Gulf Coast and nationally, he says the Economic Alliance started working with partner organizations to educate, train and employ recent high school graduates. For example, the organization created a marketing program focused on petrochemical career opportunities, geared at increasing the pipeline of people moving through the educational system and/or employed by owners and contractors.

"We started marketing the careers to students, teachers, counselors, principals, administrators and even parents—all in an effort to try and change the perceptions that were out there," says Burke. The group also assembled a speakers bureau comprised of industry (or "jumpsuit") volunteers. "We asked them to show up in their jumpsuits and talk about their careers," he explains, noting that the group's efforts extend all the way down to the middle-school level.

> “*In Texas, eighth graders must select an endorsement. That's a good point for us to be able to expose them to the career opportunities in the field and show them how affordable it is to get training—and how profitable it is to work in this industry.*”

Chad Burke
President and CEO of
the Economic Alliance
Houston Port Region

"In Texas, eighth graders must select an endorsement, kind of like a college major, but in this case, it's an educational track," Burke notes. "That's a good point for us to be able to expose them to the career opportunities in the field, and show them how affordable it is to get training—and how profitable it is to work in this industry."

In 2016 the Economic Alliance made presentations to 49 high schools and junior high schools in the Greater Houston area and spoke to over 5,200 people in the process. Year to date, it has already interacted with 3,100 students. "It's going to be a bigger year; we're on pace to almost double what we did last year," says Burke, who adds that the Alliance's ultimate goal is to create a pipeline of qualified individuals who can fill jobs at a "reasonable rate" for owners and contractors.

Is it working? Burke thinks so. "Pulling proprietary hiring information out of owners and contractors is tough; company leaders don't want to let the competition know that they're short on instrument techs or pipefitters," Burke concludes. "However, the two local community colleges that provide industrial training and degrees have shown significant enrollment increases in the targeted careers. Also, later this year, our industry association (more than 130 plants) will complete a workforce survey that gives us another barometer for understanding how many people these companies need to hire. That will provide a quantitative gauge on where they are right now, and I'm very interested to see that."

The Wheels on This Bus Turn Slowly But Surely

From his vantage point as president and CEO of AGC Houston and as a member of the board for the Construction Career Collaborative (C3), Jerry Nevlud has occupied a front-row seat at the E&C talent crisis show for years. A 501(c)(3), C3 is a not-for-profit organization that seeks to establish standards and principles for the commercial construction industry workforce. The group works to enhance career opportunities for the public good, enforce hourly payroll practices, and establish standardized safety and craft training that provides direct entry into the workforce from secondary and post-secondary training programs, according to the organization's website.

Nevlud says the group, which was formed about seven years ago, came together after a few key players in the industry realized that a workforce shortage was either already in force or right around the next corner. Two of its core focuses were on undocumented immigrants (which comprised a large majority of the state's construction workforce at the time) and misclassified workers (e.g., an independent contractor who really should have been classified as a salaried worker). "We started trying to figure out how to change all of that," says Nevlud. "And I knew that this couldn't just be an AGC initiative because it was an industrywide issue." And with that, the group created a board and began inviting different associations and contractors to participate.

Seven years later, C3 is a standalone entity with a three-person staff and a mission to continue helping the industry build out its workforce in a responsible, standards-based manner. For example, the C3 team works with general contractors on specific projects to ensure compliance with the requirements of the C3 Accreditation program. The team also verifies the pay practices of the skilled craft workers' employers and the safety credentials of those craft workers on the project site. These steps are accomplished via the C3 Training Database along with job site interviews of craft workers by the C3 compliance team.

"The goal is to create metrics and standards around in-house skills training," says Nevlud, who recalls a time in the mid-1980s when the market was experiencing a big dip and the industry was populated with a high number of union contractors. "That flipped in the 1980s, and a lot of unions fell from the radar screen," says Nevlud. "Most union contractors developed an open shop component."

At the time, no one gave much thought to the need for workforce development. That's because there was a lot of trained labor in the workforce—much of which has since retired or gone untrained (and, as such, is no longer immediately employable by the industry). Now C3 is in the midst of an all-out effort to change that. By leveraging the Greater Houston Partnership's position in the business community, for instance, the group is helping to promote better relationships among project owners, contractors, and local colleges and training centers.

Making those connections isn't always easy, particularly when one side just wants to get a building up and running as cheaply as possible and the other wants to train students the right way—a process that requires time and patience. "The wheels on the bus don't turn that fast, and we've all come to acknowledge that," says Nevlud. "But every time you have that discussion, it just carries more and more weight and there's a greater understanding of what we're trying to accomplish here."

Wanted: Portable Industry Credentials

Also a part of C3, Jim Stevenson of McCarthy Building Systems currently serves as the group's chairman. He distinctly remembers the turning point back in 2009 when the venture came together. With WS Bellows at the time, Stevenson says the main idea was to create a group that would involve "collaborative groups led by project owners" (versus just contractors). "We felt that the people who were actually building the projects needed to be involved if we were going to impact the industry," Stevenson recalls. "So from day one, we started with C3 as an owner-driven solution."

The initiative kicked off with a 50-person volunteer corps that sat down and devised a plan to "change the way that we're handling our craft workforce in the Greater Houston area," says Stevenson. **The group came up with three key pillars, which were:**

1. **Common safety training** so that employees wouldn't be given the same basic safety training repeatedly as they moved from job to job.
2. **A fair wage and good benefits** to attract people into the industry.
3. **A program for starting (or restarting) craft training** based on the specific craft.

"The licensed crafts typically have some level of craft training, as do the union subs, but both of those were in need of some improvement," Stevenson explains. "Then there was this vast group that really didn't have any craft training. It's just been word of mouth passed down and over from one generation to the next."

Centered on investing now to create a better workforce for the future, C3 set out to convince owners that there were real costs associated with inefficiencies, low productivity and poor quality. A standards-setting organization that promotes craft training and serves as a vehicle to connect craft workers with employers that are doing craft training, C3 accredits general and specialty contractors that comply with its standards.

"What we're trying to do is credential craft workers so that they become more valuable as they move from job to job," says Stevenson. "They don't have to explain to someone that they've been doing this for 20 years; there's actual documentation to that effect."

"What we're trying to do is credential craft workers so that they become more valuable as they move from job to job. They don't have to explain to someone that they've been doing this for 20 years; there's actual documentation to that effect."

Jim Stevenson
President of McCarthy Building Systems, and Chairman of C3

At the end of the day, Stevenson says C3's vision is not to develop a huge workforce but rather a small, more qualified pool of skilled workers. "We're really focused on trying to increase the quality of the craft workers that we have," he concludes, "and then credential them so that when we have the lulls, they still have the opportunity to find work elsewhere because they can take those credentials with them."

As the skilled worker shortage continues to grow, and as the E&C industry continues down its post-recession path to full recovery, the strategies outlined in this article can easily be duplicated in other urban and rural areas around the nation. Whether that means credentialing workers, pairing contractors with educational providers, or getting owners more involved in the workforce development process, now is the time to mobilize these efforts and put some time into helping to create the workforce for today… and for the future.

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Geographic Strategy: In Texas, as Elsewhere, All Construction Is Local

By Mike Clancy

A few years ago, a marketing campaign for the state of Texas used as its tag line the phrase, "Texas: It's Like a Whole Different Country."

While the tongue-in-cheek point of the statement was the diverse nature of this state and its imposing breadth and scope, it also has an interesting second definition. Many of the trends and market conditions operative here in the Lone Star State are a microcosm of the broader national picture—which is not surprising, since Texas' $1.65 trillion economy is only a little larger than that of Canada ($1.55 trillion). With an economy that large, and with that much complexity, what lessons can contractors draw from Texas that can be applied on a broader scale? While this issue of the "Quarterly" addresses several strategic questions, one which may be interesting is the extent to which, even within a single state, construction remains largely a local business.

Thinking Locally, Acting Globally

Historically, local market dynamics made it difficult to achieve scale in the construction industry. Particularly with respect to the private market, local incumbents were often the natural favorites due to their relationships and local area knowledge. Through the first half of the 20th century, local firms heavily drove construction and even major public works projects often went to the local incumbents. Apart from relatively few firms that were largely focused on major government and energy projects or significant private projects, construction was local in nature.

Starting in the 1950s, however, the increasing complexity of projects and their growth in size and scope caused regional and national players to multiply and expand. Today, the top-20 firms perform over 10% of the nation's construction volume. This trend has accelerated in the past two decades, introducing an entirely new set of strategic dynamics to our industry. Particularly for small and midsized firms, the impact of increasing consolidation at the top of the industry presents obvious concerns about future competitive dynamics.

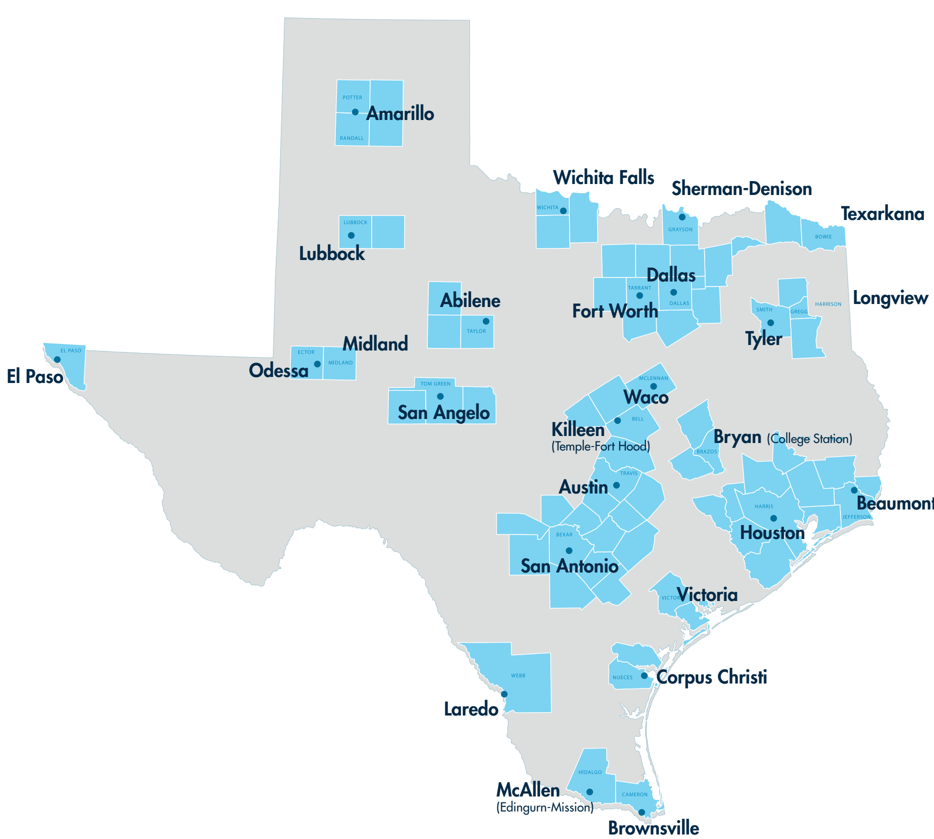
However, it is abundantly clear—from looking at the Texas construction industry as an analogue for the broader market—that this remains a business where local presence is critical. Perhaps that is not surprising, given the varied cultures and geographic distances between the largest Texas metropolitan areas, but this has interesting parallels in other parts of the country. As someone who cut his teeth in South Florida's construction industry, for example, it was often harder for firms from Fort Lauderdale to compete in Miami than it was for national or international firms—and vice versa—even though the two cities are only 30 miles apart. Likewise, here in Texas, companies often need operations in each of the major cities if they want to be taken seriously.

Culture Varies by Geography and Can Make the Difference

Because the major cities in Texas are dramatically different culturally, and with accordingly different market dynamics, firms need to have operations in multiple locations. Each of these cities has its own key industries, so firms that wish to serve those industries need to be present to win.

Houston's status as America's energy hub is well-known. The city's heart beats with the oil and gas markets, and its culture is accordingly driven by risk-taking entrepreneurs. This has led to a boom-and-bust marketplace, where projects can dry up as the price per barrel goes down. However, as the fourth-largest U.S. city by population, Houston is also home to significant investments in education construction and an impressive medical spend

Exhibit 1. Texas Metropolitan Areas



Data source: ESRI, 2017

driven by the downtown medical district. As a result, general building contractors have felt the need to have offices in Houston alongside their peers serving the industrial, refining and energy spaces. Accordingly, every one of the country's top-10 contractors has significant operations in the Houston metro area, and a quarter of the region's largest contractors have their regional or national headquarters there.

On the other hand, the Dallas metroplex, which includes neighboring Fort Worth and Irvine, is the commercial and financial capital of Texas. When combined with its neighbors, the Dallas metro area surpasses its "grown-up little brother" Houston as the fourth largest in the country. Dallas is home to many corporate headquarters and is seen as the established, mature market for the state. As one might expect, many regional and national firms with a long history in Texas house their operations in and around Dallas. Additionally, firms with a focus on corporate clients tend to find their best fit there.

Austin is home to the state capitol, and so, historically, firms that had a lot of business with the state government (particularly its Department of Transportation) found it necessary to have offices there to support that significant customer. The higher education market, embodied in the University of Texas, also drew its share of contractors seeking to be close to their clients. In recent years, though, Austin has experienced surging growth in a younger, more diverse population, driven by a significant number of technology-oriented employers that located in and around the city. So firms that work in the multifamily space, serve the technology industry or whose corporate cultures tend to favor a millennial workforce have found Austin to be a welcoming base of operations.

In addition to these cities, San Antonio and El Paso round out the list of six Texas cities in the top 20 for population size nationally and host their share of national and regional firms.

As Always, Strategy Is About Saying "No"

With so many different business cultures across such a broad geography, the challenges of serving the Texas market are obvious. Companies in other parts of the country face similar challenges, namely: How can a single firm serve multiple market sectors and geographies effectively, short of opening dozens of offices everywhere it seeks to do business?

The short answer is that it isn't possible for most firms to serve every market and geography in a place like Texas. More importantly, most firms probably shouldn't even try. This also holds true for other parts of the world. Strategy is about the opportunities a firm chooses to say "no" to as much as those it chooses to pursue. Therefore, the best strategic choice is to identify those market sectors and geographies most aligned with the firm's culture and capabilities and focus on them. Firms engaged in the energy space might focus their efforts on Houston and Midland, as one example.

But what about when your firm sees good opportunities in multiple geographies? What can you learn and apply from the companies that have been successful working across the 270,000 square miles of Texas? Here are a few good strategies to keep in mind:

1. **Align office culture with local culture.** As Henry Ford is credited with saying, "Culture eats strategy for breakfast." If this statement is true in the positive, it will also be true in the negative. In other words, if you have the best strategic reasons in the world for being in a geography, but your culture is incompatible with the culture of that geography, success will be tough to achieve.

2. **If you're unsure, look for low-cost options.** If you aren't completely certain that a new geographic opportunity is the way you want to grow your business, look for lower-investment ways to enter in the short term. Joint venture partnerships are often attractive for this reason, but other moves short of establishing a regional office can also be an effective way to "try before you buy."

3. **Don't force the issue.** Companies often follow good clients to a geography that seems like an attractive location for expansion. While this may appear to be a low-risk way to get into a new market, it can sometimes lead firms to pursue noncore work in an effort to remain in the geography, particularly if the office is led by local hires or if the geography is a desirable place to live in. Forcing the issue can lead to winning work that causes the company to lose—financially, reputationally and culturally.

4. **Be willing to "burn the ships" if necessary.** On the other hand, having a toe in a market in perpetuity is a surefire way to guarantee your firm is never seen as a truly local player. Attitudes towards "carpetbaggers" haven't changed much since the 1860s, but they now cross geographic and cultural lines. So if you've decided a specific geography is important to your firm's future success, follow Hernan Cortes' approach and burn the ships. Go all in by investing in research to understand the market, relocating key leaders from the corporate home who can drive the culture, hiring local experts, and supporting the effort with leadership from the home office.

Understanding Local Dynamics

The lessons learned while operating across a sizable geography such as Texas, with its accompanying cultural and market sector diversity, can have broad applicability for contractors across the country. Understanding the local dynamics, ensuring the geography and its associated opportunities are aligned to company culture, and making appropriate investment decisions remain critical strategic disciplines. In short, making the right decisions by knowing when to say "no" will always matter, regardless of where your strategy leads you. And, if it leads you to Texas, remember—it really is like a whole other country here.

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Texas: Successful Compensation Strategies for Navigating Market Cyclicality

By Priya Kapila

Weathering down markets and cyclical work, Texas holds steady in construction employee compensation.

A strong first quarter in the Texas oil and gas industry has some hopeful that 2017 is the year that the industry recovers from the debilitating three-year-long downturn. "We still have a long way to go, but 2017 is going to be a year of recovery and expansion in the Texas statewide oil and gas exploration and production economy," petroleum economist Karr Ingham told the Times Record News. "Activity levels will continue to expand, jobs will continue to be added, and the industry will support the broader state economy again, rather than acting as a drag on growth as it has for the prior two years."

Despite the recent fluctuations in the oil and gas market, Texas continues to generate employment opportunities that flag the state as an attractive location for workers within the engineering and construction (E&C) industry. In fact, Texas' job creation exceeded the nation's pace for the year ending in March 2017, according to Corridor News. In all, the state gained 249,000 nonagricultural jobs, an annual growth rate of 2.1%, higher than the nation's rate of 1.5%. The transportation, warehousing and utilities industries ranked first in job creation, followed by professional and business services, education and health services, construction, financial activities, and leisure and hospitality.

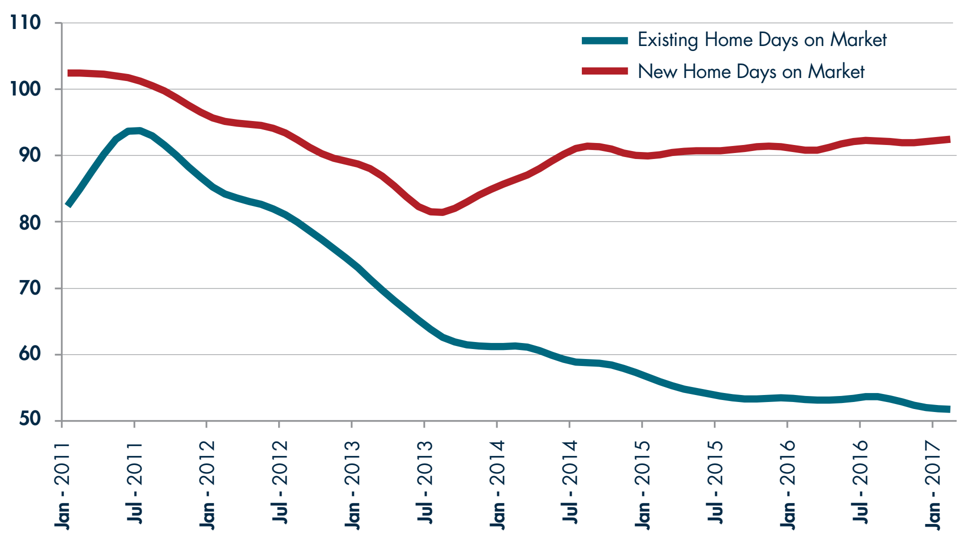
Houston: The Oil and Gas Industrial Center

The rig count is up 80% in Texas over the first quarter of 2016, and drilling permits have doubled to 1,300, the Houston Chronicle reports. In addition, state oil and gas employment has risen by 9,000 from the trough in September 2016, according to Texas Petro Index, a monthly report on the state's oil and gas activity.

A high concentration of oil and gas jobs is centered in Houston, where the most recent employment growth rates for the area from the Texas Workforce Commission and Bureau of Labor Statistics confirmed what many energy sector experts already knew: The Houston metropolitan area, along with the rest of the state, had little to no growth throughout 2015 and much of 2016. However, as noted earlier, the current outlook is more optimistic. In the early months of 2017, jobs were added to the market, and the labor force participation rate increased.

The positive view of Texas' future has far-reaching effects. For example, Dallas was the top destination in the country last year for domestic relocations, and Austin and Houston also ranked in the top 10. Such migration has put a strain on the Texas housing market, as shown in Exhibit 1. Days on market for existing homes have fallen to nearly half the 2011 average number of days. The population influx has been understandably beneficial to the residential construction market, which has seen a majority of the job growth recognized within the construction industry since 2015, according to the Texas Workforce Commission.

Exhibit 1. Texas Home Days on Market (Days)



Note: Seasonally adjusted and detrended. For single-family homes.
Source: Real Estate Center at Texas A&M University

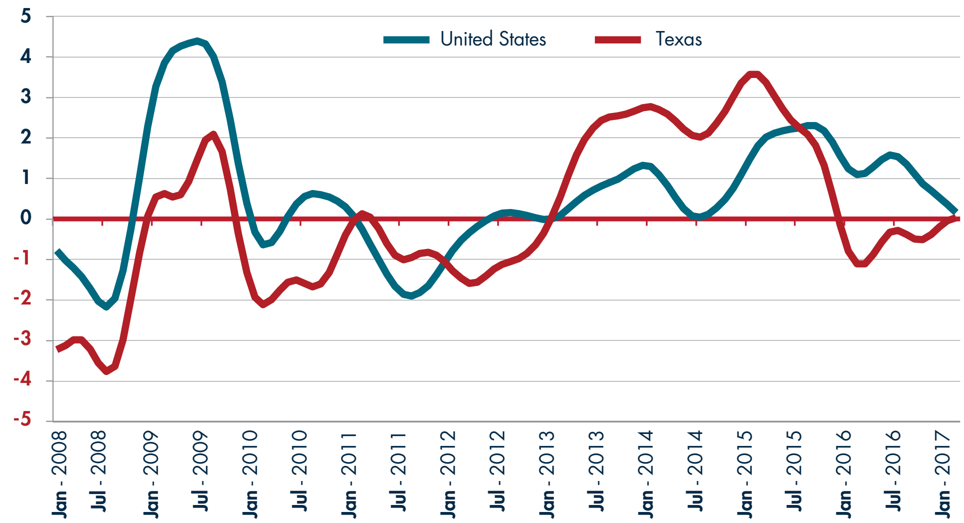
Tracking Labor Growth

Labor growth has had a mitigating effect on Texas' compensation growth. With supply being met in some key fields by new workers, there is less pressure on employers to provide aggressive compensation. The Bureau of Labor Statistics reports show that, following a rapid decline in earnings throughout 2015, worker compensation has slowly improved during the last year.

FMI's latest compensation surveys support this observation and indicate modest growth in recent years that only slightly exceeds the national average in many cases. During the same time frame, the average national earning growth rate has receded (see Exhibit 2), thus underscoring the rationale for relocation to Texas. Even with conservative job growth and compensation increases, Texas remains more attractive than many other areas of the nation.

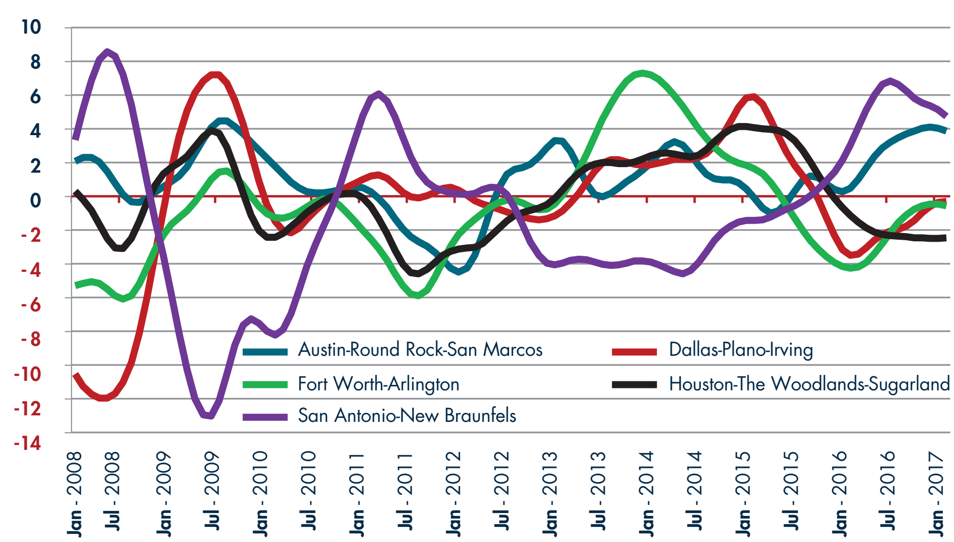
It is also important to recognize that the state's major metropolitan areas have experienced different degrees of compensation growth. San Antonio and Austin, for example, reported the greatest improvement in annual compensation growth from 2014, while Dallas-Fort Worth and Houston had slowing increases and then declines during that same time frame (Exhibit 3).

Exhibit 2. Total Private Employee Hourly Earnings (Year-over-Year Percent Change)



Notes: Inflation adjusted, seasonally adjusted and detrended. December 2016 is preliminary.
For more information, see Total Private Employee Hourly Earnings.
Source: Bureau of Labor Statistics

Exhibit 3. Major Metros Total Private Employee Hourly Earnings (Year-over-Year Percent Change)



Notes: Inflation adjusted, seasonally adjusted and detrended. February 2017 is preliminary.
For more information, see Total Private Employee Hourly Earnings.
Source: Bureau of Labor Statistics

We're seeing a similar trend in the E&C industries, although the Dallas and Houston markets are reporting small pay increases (as opposed to actual reductions). Interestingly, while Austin's average salary increases are above-market, San Antonio is well-aligned with the national average, and the increases for Houston and Dallas fall notably below market (Exhibit 4). Salary increases tend to reflect market forecasts and expectations, particularly for the coming year. Accordingly, lower pay growth may suggest that employers are proceeding cautiously and anticipate slower economic growth overall.

Exhibit 4. Average Annual Salary Increases for Select Texas Metropolitan Areas

Texas Metropolitan Area	Average Annual Salary Increases 2014 – 2016
Austin	3.3%
San Antonio	2.9%
Houston	1.3%
Dallas	0.6%

Source: FMI Construction Professional Compensation Survey

The rates of annual increase are highest right now for construction operations jobs. According to FMIs' "Construction Professional Compensation Survey", the jobs with the largest annual increases in Texas—project controls, superintendent and project manager—mirror nationwide compensation trends for these roles. Conversely, market-competitive pay levels for select support roles have fallen over the last two years (Exhibit 5).

Exhibit 5. Average Annual Salary Increase by Job Function

Job Function	Average Annual Salary Increases 2014 – 2016
Project Controls	5.0%
Project Superintendent	2.6%
Project Manager	2.1%
Purchasing	-1.2%
Quality Assurance	-1.3%
Business Development	-3.4%

Source: FMI Construction Professional Compensation Survey

Successful Compensation Strategies in a Tight Labor Market

It's no secret that the labor market for skilled workers is tight right now, with companies utilizing a wide range of strategies to find, recruit and retain workers in the engineering and construction fields. With broad fluctuations in compensation across the major metropolitan areas and job functions, firms must plan for future employment needs and take steps to assess their own competitive environments.

Once a company's leaders develop an accurate outlook of the type of talent necessary for ongoing operations and success, they can then determine just how aggressive their employee recruiting and retention strategies must be. While compensation is by no means the only consideration for effective talent management, pay has tremendous influence on attracting individuals to a company and can be used to encourage high performance and company loyalty. With that in mind, here are several approaches that Texas-based firms (and others) can use to best position themselves during turbulent times:

1. **Create a consistent compensation philosophy.** Companies are often tempted to make big changes to salary levels or offer very individualized compensation packages based on perceptions about the job market and talent quality. No organization should maintain compensation policies that are indefinitely set in stone; but on the other hand, adjustments that are discretionary or differ significantly from past practices may have negative consequences over time.

   First, there is a possibility of legal risk if employees who are performing similarly receive compensation that differs. Other effects of individualized compensation packages include greater administrative burden and negative employee perceptions of pay (and eventually, the company in general).

   To avoid the pitfalls inherent in discretionary compensation plans, companies should establish and maintain an overall compensation philosophy. Typically, the compensation philosophy should be applied consistently across all positions within the company. However, on occasion, there may be justification for different philosophies for "hot" jobs or select mission-critical jobs. If a company determines that an especially strong compensation package is needed to attract a top candidate, for example, written documentation should be used to explain the basis for the deviation from the corporate compensation philosophy. In addition, executives should also identify methods for adjusting pay accordingly for existing employees in the same job.

2. **Develop long-term incentives.** Long-term incentives are similar to formalized stay bonuses in that both are focused on key employee retention. Stay bonuses are common because they can be determined subjectively and then tracked and paid without in-depth recordkeeping. They can also be awarded as desired by the company's leadership. But just as individualized compensation packages can create unintended consequences, stay bonuses tend to cause confusion around how and why such awards are made. In fact, they may even place the company in hardship, should costly payouts be required in the future when performance is down.

   While long-term incentive plans also enable flexibility regarding plan participants, timing and amounts of awards and payout schedules, there are clear differences between long-term incentives and stay bonuses. One overt distinction is that long-term incentives are generally performance-based, as opposed to stay bonuses (which are usually tenure-based). Recipients are more likely to understand long-term incentives because the metrics determining such awards have been communicated to them. The awards are generally viewed more favorably because they reward contributions to organizational performance instead of simply recognizing an employee's ongoing presence within the company. Finally, a company can better ensure that the cost of future long-term incentive award payouts aligns with firm performance goals and success.

3. **Explore non-compensation recruitment and retention approaches.** Effective strategies for talent management extend beyond compensation. In uncertain times, for instance, programs that result in less direct cost increases may be more appropriate and financially prudent. Providing attractive benefit offerings, like flexible scheduling, telecommuting and extended paid time off, can foster positive views of the firm among current and prospective employees.

   In addition, a corporate culture and values system that identifies a dedication to staff well-being and development, if continuously reinforced by senior management, can have marked impact on attraction and retention efforts. For example, one employee at Camden Property Trust, which is ranked fourth in Fortune's 2017 "50 Best Places to Work in Texas", said, "There truly is a family environment here, and I feel valued, respected, appreciated and cared for." Reflecting a similar mindset, David Weekly Homes, ranked seventh, reports that, "Our mission is to build dreams and enhance lives, and we put our team members' lives as first on the list."

Focus on Maintaining Consistency

Although the Texas economy is certainly not alone in experiencing ups and downs, the variances within the state's numerous economies are pushing companies to stay apprised of market trends and future outlooks in a very proactive manner. When it comes to talent management, firms should assess and confirm staff resources on an ongoing basis to take full advantage of opportunities and address challenges during both strong economic times and downturns.

While the most direct strategy may be to accommodate all requests with customized compensation packages, we recommend maintaining consistency in employee pay practices, developing an overall compensation philosophy, and establishing programs aimed at attracting and retaining high performers.

Priya Kapila is the compensation practice leader with FMI Corporation. Priya is responsible for leading the compensation consulting practice of FMI Compensation. Services provided to clients are primarily focused on the areas of executive compensation, organizationwide salary structure development, and short-term and long-term incentive plan design. She can be reached at *pkapila@fminet.com.*

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What's Driving Contractor Acquisition Trends?

By Scott Duncan

Understanding buyer strategy is essential to comprehending exit options and making the best possible choice for your company.

More than half of today's construction firms will change hands over the next 10 years due to the impending generational shift within the construction market. This shift will undoubtedly provide substantial opportunity for acquirers while also leaving many multigenerational, family-run construction firms with limited transition options. Internal transition will be the preferred path for many, but other owners will assume that a third-party sale is not only feasible, but also the best way to maximize value.

This is a critical mistake.

Unfortunately, for many contractors, a third-party sale is not feasible. For starters, contractor markets have few barriers to entry and are inherently people-dependent. For many companies, the very individuals involved in the management of the company are often those who want to retire from it. And contrary to popular belief, most buyers do not have a bench of managers that they can send in to run newly acquired companies.

Adding to the challenge, strategic buyers frequently evaluate acquisitions with a "buy versus build" mindset, which makes it difficult to justify the capital investment that acquisitions often require. However, while transactions in contractor markets can be challenging, there are ways to make firms more salable and attractive to the third-party marketplace. Understanding them is a key business planning exercise for all business owners, but doing so first requires an education on buyer behavior.

Want to Be a Contractor? Have a Shovel?

Barriers to entry are extremely limited in many contractor markets. As a result, most contractors face enormous competitive pressures. These barriers to entry differ by market and project size, but the reality is that contractors rarely find themselves in a niche position where price is not a critical driver of an owner's decision-making process. Because of this dynamic, consolidating markets or driving value through economies of scale is usually a limiting factor for contractors.

So how do buyers react in a low barriers-to-entry market? Typically, they rely on one of three solutions: Achieve scale that allows them to bid on larger projects in which capital costs are high (thus excluding smaller players); integrate vertically in an effort to deliver projects more cheaply or at a higher overall project margin; or diversify into multiple markets over time to limit the effects of market concentration.

Put simply, there is no strategic panacea. Even larger contractors that deliver multibillion-dollar projects are subject to substantial cost pressures. While vertical integration deals (e.g., a general contractor acquiring a trade subcontractor) will likely increase as labor constraints continue to influence project delivery and overall contractor strategy, this approach produces a limited number of contractor success stories.

Texas Comes Into Focus

By far the most common expansion strategies for contractors are geographic and service diversification. And the strategy of "where and how" to compete often leads to questions around key customers, labor dynamics, buy versus build and other factors. In the end, however, the analysis is frequently driven by one critical question: Where is the growth? And since the great recession of 2009, Texas has been at the top of the list of states that are experiencing healthy economic growth.

On an overall basis, Texas is the largest market for private, nonresidential construction put-in-place (CPIP). Since 2011 (the trough in private, nonresidential CPIP), Texas has outgrown other states by nearly a 3-to-1 margin, with a 26% compound annual growth rate (CAGR). This was largely due to the growth in the oil and gas/industrial markets, and also to the favorable investment environment in Texas, which drives substantial amounts of private commercial dollars.

Texas is third, behind Washington, D.C., and Nevada, in the strongest growth in commercial construction since 2011, growing from $5.2 billion in 2011 to $12.8 billion in 2016. In fact, lodging in Texas grew the fastest of any state in the country, up 22.5% since 2011. In short, the Texas construction market is one of the largest and fastest-growing in the U.S. With its low taxes, a business friendly regulatory environment and strong infrastructure spending programs, Texas attracts a high number of new businesses every year. And, as such, it's a very attractive market for companies looking to acquire construction firms.

The Risk Spectrum of Contractor Attributes

Operating in a growing market alone does not necessarily dictate salability; other factors play a key role as well. And all contractors are not created equal. There are numerous attributes that affect the salability and value of a contracting firm. The most important of these include:

1. **Strength of the Management Team.** The strength, depth and duration (i.e., retirement timelines) of the management team are among the first questions acquirers will ask about target companies. If one or two owners/managers are actively managing multiple aspects of the business and are seeking to retire shortly after a transaction, what is the buyer actually acquiring?

2. **Project versus Recurring Revenue.** Project-based businesses typically demonstrate greater volatility in revenue than companies with non-project-based revenues. Buyers tend to treat predictable, consistent revenues much more favorably than those that are more volatile in nature.

3. **Bonded versus Unbonded Work.** In some markets bonding is required to obtain and execute work. For companies in these markets, the buyer pool can be limited to strategic buyers who understand and are willing to accept this risk. Financial buyers typically shy away from bonded revenues due to the effect bonding has on the ability to finance transactions primarily with debt.

4. **Competitive Hard Bid versus Negotiated T&M.** Companies operating in highly competitive, hard-bid markets are at much greater risk of job losses. Furthermore, they are more easily displaced on bid day than companies operating in a negotiated capacity. Buyers understand this risk and react accordingly.

5. **Prime versus Sub.** Companies working in a prime capacity for clients drive more value in acquisitions than those who serve in a subcontractor capacity. That's because subcontractors are dependent on general contractors (GCs) or prime contractors for their work and are often chosen based on price.

6. **Self-performance.** Self-performance is a growing bottleneck in the construction supply chain. Companies that control the labor pool are inherently less risky than those that are dependent on subcontractors.

7. **Size and Diversity.** Larger, more diversified companies present less risk to a potential buyer than smaller, less diversified firms. This can play a key role in salability, particularly in heavy civil and general contractor markets.

Other factors can also weigh heavily on buyer interest. Many strategic buyers, for example, are not interested in entering states with high rates of taxation and/or substantial regulatory compliance burdens. Workforce issues can also play a key role in salability, depending on the market.

Risk Attributes at Work

While buyers often prefer prime contracting relationships, there remains a strong consolidation trend in the specialty trade market. Companies like Comfort Systems and EMCOR are serial acquirers that understand and accept many of the challenges subcontractors face. And while buyers almost universally prefer recurring revenues, dozens of transactions with lump-sum, competitive-bid contractors are executed annually. As a result, it's important to look more closely at individual markets.

GCs and construction managers (CMs) for example, frequently execute in a lump-sum, competitive environment, and projects are frequently bonded. These attributes and the lack of self-performance limit the buyer pool for GCs. As a result, many of these firms turn to internal transition as an exit option. However, larger general contractors have benefited from the emergence of the international buyer community that, with ample capital and nearly unlimited bonding capacity, has actively acquired firms in the United States. Recent Texas examples of this include Balfour Beatty/SpawMaxwell/Howard S. Wright and Webber's (Ferrovial's) acquisition of Pepper Lawson.

Heavy civil firms face many of the same market pressures as GCs and CMs, but with the added stress of operating in a highly competitive bid environment with more complex, risky projects. However, the bright spot for heavy civil firms is that foreign interest in this market has grown substantially over the past two decades. Italian-based Salini Impregilo's acquisition of Connecticut-based Lane Construction is a good recent example of foreign interest in this market.

Specialty trade contractor transactions are fairly common in the industry. And while they are frequently in a subcontract position, specialty trade contractors can increasingly find opportunities to develop prime relationships with clients through service contracts and other mechanisms. Furthermore, the self-performing nature of this work is attractive to many acquirers. Recent examples of mechanical/electrical/plumbing (MEP) transactions include Comfort Systems' acquisition of Dallas-based Dynaten and Florida-based BCH Mechanical.

Who Is Buying Texas Contractors?

FMI reviewed its historical database of transactions, coupled with publicly announced transactions, and focused on identifying key transactions in the following segments since the end of the great recession:

1. ***General Contractors/Construction Managers* –** Companies performing general contracting and construction management work primarily in commercial markets and typically subcontracting the majority of the work.
2. ***Specialty Trade Contractors* –** Self-performing contractors that typically act as subcontractors to GCs and CMs, most frequently serving commercial markets. These contractors are a diverse group and range from electrical contractors to mechanical/HVAC contractors to concrete and earthwork contractors.
3. ***Civil Contractors* –** Contractors executing primarily government projects (e.g., roads and bridges/water infrastructure) and typically operating in a prime capacity.
4. ***Industrial/Energy Infrastructure* –** Contractors working in industrial, oil and gas or utility markets with a primary focus on construction or construction services delivered in a prime, self-performing capacity. This excludes hauling, roustabout, inspection, wellhead services and other nonconstruction-related oilfield services.

Finally, industrial and energy infrastructure contractors are among the most salable in contractor markets. Higher barriers to entry driven by operator qualifications, safety and experience requirements—and large, blue chip clients—create an investment environment that both strategic and financial buyers find favorable. The prime, self-performing nature of these companies adds further value to strategic buyers. The Wood Group's acquisition of Infinity, Quanta's acquisition of Price Gregory, Primoris' acquisition of Sprint Pipeline, Team's acquisition of Furmanite, and Zachry's acquisition of JV Industrial are all examples of recent deals in this market.

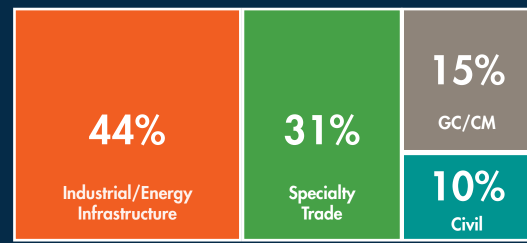
Assessing the Implications for Your Firm

Regardless of where your firm falls on the salability spectrum, early preparation can pay extraordinary dividends. Address the questions below as early as you can:

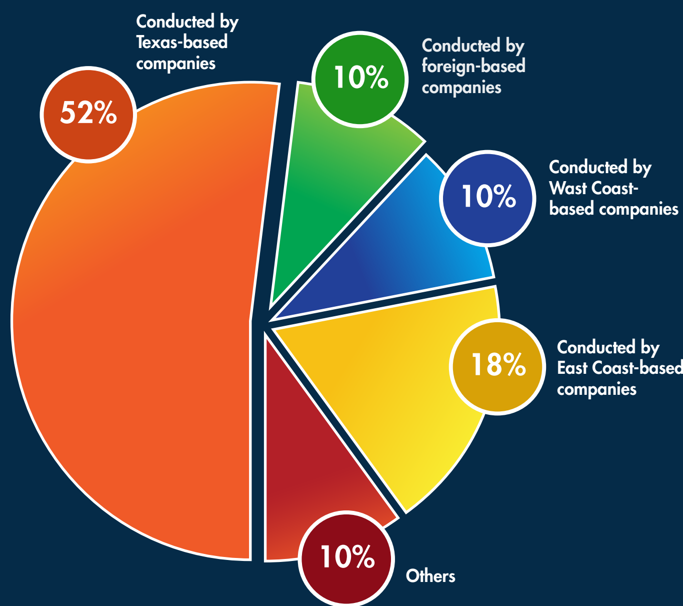
- Where does your firm fall on the salability spectrum? If third-party sale is not feasible, have you explored how long an internal sale will require?
- What legacy do you want to leave? Does a third-party sale facilitate that?
- What are your valuation expectations? Many owners assume a third-party sale is the best way to maximize value, but this is typically not the case. Internal sales can often reap exiting owners substantially greater proceeds, so long as they have the patience and willingness to work through an internal sale.
- Who will manage the company post-closing? Do they have the leadership capabilities and management skills to be successful? If not, how will you prepare them?
- Does the company have robust systems and processes that will facilitate a thorough understanding of the company from an outside perspective? If it's all "in your head," there's a problem.

FMI's analysis of M&A transactions since the recession in the Texas contractor market yielded the following key data points:

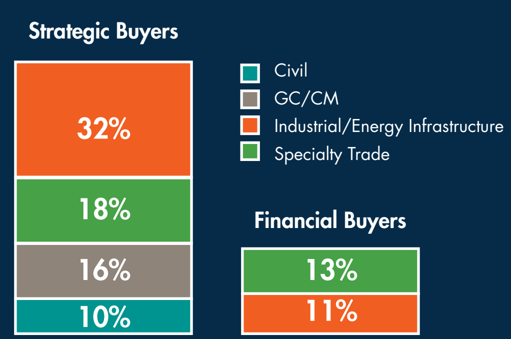
Transactions
by Market Segment



Total Transactions
by Geography



Transactions
by Buyer Type and Market Segment



Source: FMI, Capital IQ

Every construction firm has its own set of attributes that will determine salability and value. A clear understanding of your ownership objectives, coupled with an understanding of salability and value, will allow you to prepare for a successful transition.

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Why Diversity Matters: Leadership Lessons From the Lone Star State

By Tim Tokarczyk, Lauren Ramsay and Emily Livorsi

Key lessons on how to create an inclusive and diverse corporate culture.

Texas has always had a larger-than-life persona. Whether it's the well-known slogans, its sheer size, "America's Team" or the state's many contributions to American culture, Texas has historically loomed large in the public consciousness. As leaders, can we learn something from the Lone Star State?

It certainly offers us an interesting case study. The state is one of the fastest-growing in the country. According to the U.S. Census Bureau, between July of 2015 and 2016, the population of Texas grew by more than 430,000—a number higher than the growth in any other state in the country. And it's not just numbers of people that are increasing; diversity in Texas is exploding. Hispanics are the fastest-growing demographic (now making up 38% of the population) and will be the largest demographic group in Texas by 2020.[1] At that point, Texas will be a "minority majority" state.

Texas is also home to many immigrants, and in 2015, 66.9% of new foreign-born immigrants to Texas were of Latino origin.[2]

It's not just people, though. Construction projects are up too. According to Texas Contractor, "For FY 2017, TxDOT has slated approximately $5 billion toward traditional-delivery construction projects and another $2.5 billion for design-build construction projects. Last August, TxDOT gained an unprecedented budgetary advantage

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[1] Block, Melissa. "As Texas gets more diverse, educators grab the bull by the horns." Apr. 1, 2014. http://www.npr.org/2014/04/01/297719334/as-state-diversifies-texas-educators-grab-the-bull-by-the-horns

[2] DePillis, Lydia. "Texas again tops the nation in population growth." Dec. 20, 2016. http://www.chron.com/business/texanomics/article/Texas-again-tops-the-nation-in-population-growth-10809552.php

when the Texas Transportation Commission approved the 2017 Unified Transportation Program (UTP), which dedicates $70 billion in anticipated funding to major transportation projects and programs over the course of the next decade."[3]

There's a lot happening in Texas, and for leaders in the industry, there are significant lessons to be learned. Here are three that every E&C firm should be aware of:

1. Leveraging Diversity Pays Off

Whether you are leading in Texas or elsewhere in the U.S., managing diverse groups of people will become the "new norm" in the coming decades. Today, the differences among people account for one of the largest leadership challenges we routinely face. If you could lead a team of people who think and act just like you do, leadership would be easy. You would simply show up, do what comes naturally to you, and your employees would respond positively. However, while our differences and diversity create leadership challenges, they also create exceptional opportunities if we can leverage them. Harnessing different perspectives and approaches leads to better results.

As leaders, how can we overcome the challenges of diversity and use it for our benefit?

Think about the last several challenges you faced as a leader. Most of them were likely rooted in differences of opinion. Perhaps two of your direct reports were engaged in conflict, or your team was split on how to address a strategic issue your company was facing. Perhaps you were struggling with an owner who just didn't see things the way you did. Different perspectives may feel like a constant obstacle and can be heightened in the pressure cooker that is the construction industry. But by seeking to understand these different perspectives—and embracing them—your organization can be more innovative. In fact, according to a study published in the journal "Economic Geography," "businesses run by culturally diverse teams are more likely to create new products than homogeneous ones."

This is an opportunity for you to be able to better serve your diverse customers, investors, employees and the community, which ultimately drives business growth.

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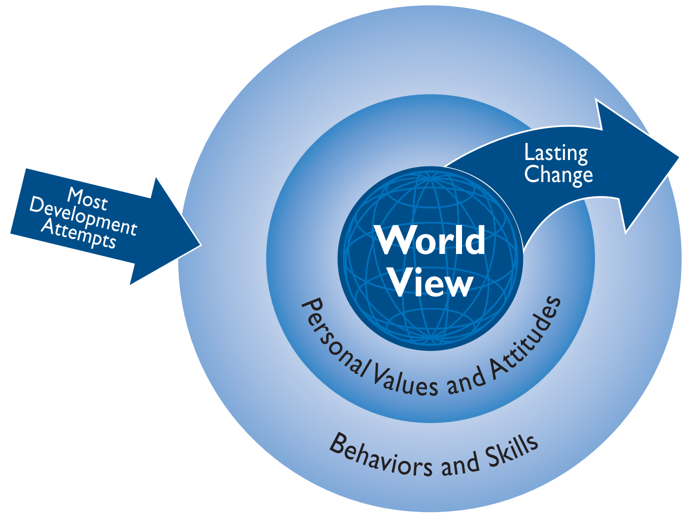
[3] Bender, Erica. "2017 Texas Construction Industry Forecast" Jan 2017. http://texascontractor.acppubs.com/trends/2017-texas-construction-industry-forecast/

2. Worldview Drives What People Want

Because people have their own unique worldview, they also have different perspectives (Exhibit 1). We define a worldview as the set of beliefs and assumptions each person holds, consciously and unconsciously, about how the world operates and how we operate in the world. Your worldview is heavily influenced by your background and experiences. As the demographics of our society and organizations shift, the dominant worldview may also change. However, even if a worldview may be common in one ethic group, for example, you'll still find two people of similar backgrounds who have different worldviews. Our worldviews are shaped by the total of our experiences. For example, two people with very similar backgrounds will still have had different family experiences; different travel experiences; different teachers, coaches and mentors. All of their unique experiences will lead them to view the world in their own way, even though they share much in common.

Exhibit 1.

Impact of World View



Source: FMI Center for Strategic Leadership

Texas' booming diversity is an example of the leadership challenges we will all face as we become a more diverse industry. Imagine how the varied experiences of a diverse, multicultural team will impact each member's worldview. Given the differences in worldview that you are likely to face among your teams, customers, investors and the community as a whole, you will need to find ways to embrace differences. And as a leader, you need to navigate those differences to build a unified, aligned and coherent team.

While this may feel like an insurmountable challenge, great leaders accomplish it every day with the teams they're working with industrywide. The best leaders intentionally acknowledge that our people will have alternative ideas and needs than ours. Great leaders recognize that the best teams don't all think alike, yet so many leaders get tripped up when they assume everyone thinks like them. Leaders have two choices—they can lead with a "my way or the highway" style (a path that far too many leaders select), or they can acknowledge that they don't have all the answers and encourage their teams to share their ideas. This can be a powerful source of new ideas, innovations and potentially competitive advantages.

Great leaders also recognize that the individuals on their teams have different needs and preferences. This is the employee value proposition, or what your employees "care about." By better understanding what team members value, you will be better-positioned to offer what they appreciate. That might be more or less structure in how they do their work, public recognition, a cash bonus, time to volunteer in the community, family involvement in company events or appreciation for their part in building the larger whole.

3. **It's Time to Plan for Ownership Transfer and Succession Management**

   Texas certainly has a leg up on much of the rest of the country in terms of diversity, and that fact will present great opportunities only if leaders can overcome the challenges outlined in this article. One of the interesting areas for further exploration involves succession management. As baby boomers retire and exit the industry, organizations will increasingly need to turn to the next generation for company leadership. The competencies required to lead multicultural teams are different and must be factored in when selecting future leaders.

   Companies also need to take a careful look at the internal leadership pipeline and ensure that they have pools of potential future leaders who can be trained to lead diverse organizations in a rapidly changing industry. That pipeline must include candidates who not only have insight and empathy but also can embrace different worldviews. There should be no barriers in career progression opportunities across backgrounds. Companies should also assess their leadership development structures and ask themselves if they truly have the processes and tools in place that will allow them to develop the leadership skills and technical skills necessary in the future. Being thoughtful and intentional about these issues will help the organization make a smooth transition in leadership and ownership when the time comes.

How to Get Started With Creating an Inclusive, Diverse Corporate Culture

Simply put, diversity is about differences and mutual respect for those differences. It's about a creating a culture where each individual can thrive and be productive. Achieving that goal requires a number of steps. Here are six ways to get started:

1. **Start with total buy-in from the top.** Leaders and executives must show complete commitment that they value and respect all members of the organization (as well as its clients, vendors and other stakeholders) through their actions and words.
2. **Obtain buy-in from all levels.** Employees from all levels of the organization should be included in the very early stages of diversity planning. Planning groups and action teams should have representative participation of most primary, secondary and organizational dimensions where possible. Although 100% direct inclusion is seldom possible, representative inclusion is almost always possible with some creative thinking.
3. **Link diversity to the organization's strategic goals.** Diversity plans that are tied directly to a company's strategic business plans have a much better chance of succeeding than those that are not.
4. **Encourage continuous learning.** While training is not the only factor in creating a successful diversity program, it is an important part of the process. Programs must be carefully planned and relevant to the organization, as many of the topics that arise during diversity training can be extremely sensitive to some employees. Use experienced facilitators whenever possible.
5. **Make diversity part of individual performance appraisals.** Communicating performance expectations regarding diversity helps to build accountability into the process and also shows organizational commitment.

6. **Recognize that diversity is not just about differences, but also about flexibility.** Employees who are offered flexible benefits, flexible scheduling and an equitable balance between their work and personal lives are more likely to have higher morale and greater productivity, and typically will stay with the company longer.

Texas firms have embraced the state's diversity and are working to integrate differing worldviews into their operations. As they find ways to meet the needs of diverse clients, employees and other stakeholders, those companies are growing and thriving. Finally, firms that are at the top of their games are being intentional about planning for succession and ownership transfer that will support a sustainable business well into the future.

A company that values diversity reflects today's changing world and marketplace and creates a fair, safe and legal environment where everyone has access to opportunities and challenges.

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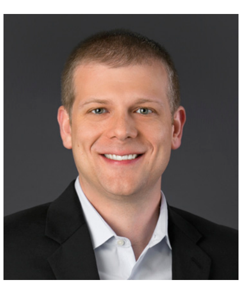

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Leading Innovation:
Insights From Industry Executives (Part 3)

By Kim Morton and Ron Magnus

Examining the influence of culture, talent and leadership on innovation.

A question we often get asked at FMI's Center for Strategic Leadership (CSL) is, "How do I lead in this market with all of the changes that are taking place?" Changes are coming at us faster than ever, and leaders are struggling to keep up. These shifts come in many forms, but innovative and disruptive changes can often be the hardest to lead through. Surprisingly, leaders who have figured this out are not focused on the change itself—or anything near it. Instead, they center on a much broader, longer-term area of the business related to developing their cultures, talent and leadership.

As we continue our series, "Leading Innovation: Insights From Industry Executives," we focus on how organizational culture, talent development and leadership influence the innovative process. During our intimate, one-day "think forum," Russ Becker (APi Group), Tom Scarangello (Thornton Tomasetti) and Atul Khanzode (DPR Construction) all agreed that these three key areas sustain their success in this ever-changing industry. This article summarizes these executives' insights and offers practical industry examples.

The Influence of Culture, Talent and Leadership on Innovation

Through various bouts of trial and error, Tom, Russ and Atul have learned just how powerful their organizations' culture is in implementing and sustaining innovation. Talent that is primed and ready to receive change, as well as leaders who are well-equipped to guide the changes, has proven to be a key driver for their success as industry leaders. Here are the three topics we discussed in our think forum:

- Your culture will determine if innovation succeeds or not—build it wisely.
- The right talent can drive and absorb innovation—invest in it.
- Your leadership team is your secret weapon for innovation—equip it appropriately.

Your Culture Will Determine If Innovation Succeeds or Not—Build It Wisely

Some of the most distinct organizational cultures in the world were built with purpose, intentionality and consistency. Without those three elements, leaders often struggle to make culture shifts stick long-term. Russ, Tom and Atul brought up the power of their internal organizational cultures multiple times during our day together. In summary, they noted:

1. **Building a culture of innovation takes time and many real-time course adjustments.** Consistently reinforcing the value of innovation, testing disruptive ideas and rewarding people for successful implementation are great ways to build a common mindset across the company.

2. **Internal collaboration influences external collaboration.** Cultures that are accustomed to collaboration in all areas of the business can lean on each other to build off each other's ideas and solve problems. It's not just an expectation for these companies; it's a natural way of working to get things done. When this happens inside the company, partners on the outside notice and are willing to collaborate on new or different methods for project delivery and/or addressing challenges when they arise.

3. **Cultures that encourage trust and collaboration can generate innovative ideas and withstand disruptive changes much more easily.** Atul noted that, "Our work is really about bringing people together. When humans trust each other and feel connected, they are willing to take risks, be vulnerable with radical ideas and try new approaches." Demonstrating trustworthy behaviors from the bottom to the top is not only expected within DPR, but also rewarded.

   Integrated Project Delivery (IPD) has driven the success of many of DPR Construction's innovative projects. Instilling the principles of IPD into the training, development and performance reviews for employees reinforces the value of collaboration and the influence it has on making innovation stick.

4. **Many innovative cultures, like the one at Thornton Tomasetti, recognize opportunities where others see risk.** Tom noted that, "Cultures that focus on the big ideas and simultaneously see challenges as opportunities are the ones that are keeping up in this market. We encourage all of our engineers to see a challenge and spend time finding the opportunity to innovate with each other on every project." This doesn't happen in the occasional pocket; it's encouraged on all internal and external teams throughout the organization.

5. **Setting a vision for innovation and clarifying what innovation means within the context of a company is key.** When everyone knows where he or she can win in the marketplace (related to innovation) and how it applies internally, the culture is likely to rally behind the vision and help support it throughout the ebbs and flows.

6. **Cultures that can't see changes, or that don't know how to respond to them, frequently reject new, innovative ideas from their employees.** If people have witnessed how to handle change and know how to respond in their own context, they tend to thrive with disruption swirling around both internally and externally to their business.

The Right Talent Can Absorb and Drive Innovation—Invest in It

Talent development and talent retention have been common themes in our industry for years. While we often hear leaders discuss their labor shortage challenges, Atul, Russ and Tom seemed unfazed by this issue. They acknowledged that they have normal turnover, but their focus on hiring the right talent has fueled innovation throughout their companies over the years. That is only one factor that leads to successful innovation, but they all noted that it works. Here are a few other key highlights they discussed:

1. **To be innovative, you have to be willing to invest in finding the right people, not the people you are comfortable with.** Russ Becker noted that, "It's always a little bit of a risk to try something new, but APi knew that investing in our people and leadership first would bring huge successes in the long run." All three leaders agreed that investing in talent with intention and purpose has helped them lead innovation well.

2. **Supporting your talent with time and monetary resources during times of rapid or disruptive changes enables employees to flourish (rather than flounder).** This is one form of investment that reduces stress, increases engagement and provides the best results for the masses of people impacted by change and innovation.

3. **Unleashing great talent can sometimes be easier said than done, but it can lead to incredible shifts in your business.** Atul said, "If you see people with huge potential that you really want to retain, give them the opportunity to spread their wings, leverage their brains and lead their own thinking. They will do powerful things!" Tom, Russ and FMI all agreed that reducing obstacles and allowing great talent to flourish have resulted in some of the industry's greatest success stories.

4. **Some companies have several, if not dozens, of people who are wired to think differently about the business or project delivery.** The concept of innovation pods was discussed at length, since it's another way to help people come together in a safe "incubator" to create ways of winning in the marketplace. Given the limited amount of time this group of leaders has on its hands, they would all encourage other organizations to consider this route if their organizations want to drive innovation in the industry.

Your Leadership Team Is Your Secret Weapon for Innovation—Equip It Appropriately

During times of change and innovation, people in the organization look to their leaders for guidance, direction, motivation and vision. They thrive on the leader's ability to deal with ambiguity while creating clarity—a daily task for many leaders. How well you equip your leadership team will determine how well your company absorbs change and innovation. Get this right and your leadership could be your secret weapon to leading innovation. In fact, developing leaders who can lead and influence others during times of disruption and innovation was a hot topic during this session. Here are some highlights that we discussed:

1. **How your leadership team responds to change and innovation will likely dictate whether or not innovation sticks long-term.** Helping your leaders learn to pause, consider the opportunities and the risks, and listen before responding have helped employees at all levels across APi Group, Thornton Tomasetti and DPR Construction.

2. **Adaptability and agility are two common competencies to look for in leaders of innovative companies.** The ability to deeply understand the business—and then adapt to and maneuver around the changing dynamics of the industry—is essential to long-term success.

3. **Where leaders focus their time and energy matters more than most realize.** Russ said, "Leaders shouldn't think in terms of innovation and disruption happening around them. They should think in terms of leading the right people so they can develop new ideas and leverage technology." The rest of the group agreed that if leaders focus on the people, then the people themselves will be able to focus on the actual innovation.

4. **Give your leaders the freedom to lead their own way.** APi Group is known for its internal leadership development programs. Russ also commented on the firm's approach to innovation—through its leadership. When APi's leaders are laser-focused on giving people the freedom and permission to lead how they want, Russ says creative solutions naturally emerge. Getting out of the way and letting leaders find their own paths can also accelerate the innovative process.

5. **Leaders make mistakes when leading through innovative or disruptive shifts.** It's a natural part of leadership that most people don't like to talk about, but this group found it very helpful to acknowledge the fact and discuss it. Helping leaders learn from their mistakes (related to both innovation and non-innovative matters) is something that all participants perceived as critical in driving longevity for organizations in our industry.

6. **Leaders who can leverage the diverse mindsets, experiences, backgrounds and personality profiles on their teams achieve higher results** than those who tend to put people into general roles. Being able to identify and pull from each person's unique gifts and talents takes time, patience and a lot of listening to do it well.

Thank You

This is the final article in our three-part series on how to lead innovation. FMI would like to send ***a special thank you to Russ Becker, Tom Scarangello and Atul Khanzode*** for taking the time to meet with us in person and sharing their insights for an entire day. A common theme from the conversation was the limited amount of time these leaders have, so we are grateful they made the time for FMI!

For more information, please contact Kim Morton or Ron Magnus.

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Construction Joint Ventures: Texas Style

By Karen Keniff

Joint ventures are a good way to grow a construction business, particularly when dealing with large and mega-projects.

With a growing economy and a new administration in Washington, D.C., stating its commitment to repairing America's infrastructure, the atmosphere within the construction industry could almost be described as jubilant. After a 5% increase in 2016, total U.S. construction put in place for 2017 is expected to increase 6% to $1.23 trillion according to FMI's latest Construction Outlook.[1] This means contractors around the country are gearing up for a busy year.

For some Texas contractors, this encouraging economic news comes as a great relief. The low oil prices of 2015 hit parts of Texas hard, with Houston seeing a 49% drop in construction starts that year.[2] The Dallas market, however, weathered the storm better. With a more diverse economy, the Dallas-Fort Worth-Arlington metro area had $17.8 billion in new project starts in 2015, 19% more (in dollar terms) than the year before and $1.2 billion more than Houston.[3] The positive trajectory continued in the Dallas market during the 2016 January-June period, with Dallas-Fort Worth reporting $2.8 billion, up 27% over the prior year.[4]

Like so many things in Texas, many new construction projects are expected to be large. Many of these projects will be put out to bid with specific requirements regarding specialized technological or heavy industrial expertise, staffing capacity and large project financing defined during the bid process. So what is a contractor to do when a large project is put out to bid with very specific requirements regarding expertise and staffing, but the interested contractor can't address all of those requirements in-house?

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[1] FMI's Construction Outlook First Quarter Report, 2017.

[2] Carlyle, Erin. "Building Boom Towns: The Metro Areas with the Most New Construction." Forbes. 10 February 2016.

[3] Ibid.

[4] "DFW Economic Indicators." Federal Reserve Bank of Dallas. 25 October 2016.

A Joint Venture May Be the Answer

Joint ventures have been effectively used in the Texas market and elsewhere to enable contractors to respond to large project bids. By utilizing a joint venture format, contractors may be able to easily expand within a specific market without having to borrow a significant amount of funds or look for outside investors. By joining together, construction firms can have the opportunity to maximize their areas of expertise and profits while remaining flexible.

Joint venture agreements can be established for a limited life span, or they can cover only part of a construction project. Longer agreements can have the added benefit of enabling contractors to strengthen relationships and leverage their expertise in an active construction market. Overall, joint ventures can help spread the risk and liability between partners, while sharing control and taxes associated with any large project.

Deciding to form a joint venture is not a simple decision. Not only should co-venturers help ensure that partners in the arrangement have shared business goals and sound relationships, but they also need to understand the best joint venture option for a particular project. The structure of joint ventures varies, depending on the type of project as well as the anticipated length of the relationship.[5]

To understand their legal rights and duties, contractors should seek legal and tax advice before entering into a joint venture agreement. Listed below are some of the typical joint ventures construction companies enter:

1. **Integrated joint ventures** involve nonlinear, complex projects split between two or more partners. These partners combine resources and employees, as well as share profits and losses according to their percentage of interest in the venture.

2. **Nonintegrated joint ventures** are restricted, non-partnerships. Every party is assigned a range of duties and is responsible for the profit, loss and resources related to that work.

3. **Combination joint ventures** involve elements of both integrated and nonintegrated joint ventures and are used for more complex projects. Parties to the agreement are responsible for assigned duties and their profits and losses.

4. **Equity joint ventures** involve two or more parties that create a separate legal company to carry out a project. The parties establish equity capital and agree on objectives such as staffing, profit sharing, the furnishing of bonds and other resources.

5. **Contractual joint ventures** involve two or more parties that form a partnership to achieve the business goals of a short-term construction project.[6]

Because partnering with another business can be complex, joint venture agreements should not be entered into without proper forethought and planning. There needs to be clarity regarding the relationship and clear communication of responsibilities of all parties. It is best that both parties have similar levels of expertise and investment

[5] Trent Cotney, P.A. "Types of Joint Ventures in the Construction Industry." Accessed 30 March 2017.

[6] Kale, V.V., et al. "Joint Venture in Construction Industry." IOSR Journal of Mechanical & Civil Engineering (IOSR-JMCE), ISSN: 2278-1684,PP: 60-65.

in the relationship, as well as an understanding of each partner's management style. Ultimately, success in a joint venture depends on a thorough understanding of aims and objectives that are clearly communicated to everyone involved in the new organization.

Steps to Consider When Creating a Joint Venture

Entering into a joint venture requires the contractor to be well-informed in order to build a successful business relationship. It is important to assess the success of a joint venture; here are some of the steps that should be considered:

- Make sure the venture's objectives are very clear and successfully communicated to all parties.
- Understand the level of expertise, investment or assets that each partner brings to the venture.
- Evaluate the different cultures and management styles to ensure successful integration and cooperation.
- Establish leadership and support structure in early stages of joint venture development.

Understanding Risk Exposures

When working with the parties involved in each venture and providing coverage for those ventures, insurance companies strive to understand the total exposures of the joint venture arrangement (rather than looking at the risk exposures of each party to the agreement separately). For a contractor that has a good relationship with its insurance carrier, for example, underwriters will analyze the business from the perspective of a new account and will not assume that the joint entity has similar risk exposures as its current business.

Whatever structure the joint venture takes, it is important to realize risks pertaining to this venture may be significantly different than the risk exposures for the individual corporate entities involved in the agreement. Contractors involved in these types of agreements should consider obtaining a separate coverage policy for each joint venture. In this instance, the joint entity will be the named insured on the policy.

In addition, companies entering into a joint venture should make sure they are well-versed regarding the insurance coverage ramifications of this shared risk. When a joint venture is approached as a separate legal entity, parties are encouraged to consult with their broker and insurance carrier to understand possible exposures. The insurance program should ensure the severability and removal of the ability of one carrier to subrogate against any member of the joint venture. This can be accomplished using proper coverage forms and endorsements.

Partners should also determine whether they should be added as additional insureds on the joint venture's general liability and umbrella liability policies. If the joint venture includes a design firm and a general contractor, for instance, all parties should consider professional liability exposure, which is not usually covered on a standard Commercial General Liability policy.

Policy Language Matters

Joint venture stakeholders should also pay special attention to the policy language pertaining to employees of the joint venture, as well as to the employees who are hired separately by one party of the joint venture.

- Direct employees of the joint venture can be insured on a separate workers' compensation policy in the name of the joint venture. An endorsement may need to be added to the policy to include the joint venture as an insured. By adding an endorsement, coverage is typically limited to employees of the joint venture and specifically excludes coverage for employees of the member companies.
- Employees hired separately by one party of the joint venture may not be fully covered by the joint arrangement. For this reason, all endorsements and indemnity statutes must be carefully evaluated.

Joint ventures usually take high-performing employees from each partner organization to the arrangement and move them into the joint venture. To successfully entice high-performing workers to join the new entity, those staff members must be convinced of the opportunities available to them through this newly formed organization. Many times, these employees may perceive risks associated with joining a new entity too great to ignore. For this reason, sign-on bonuses, bonus programs and retention awards are often used to attract the most talented employees to the joint organization.

Beyond the Joint Venture

When a joint venture concludes, there may be liability risks that exist beyond the life of the joint venture. Whether it is contract liability, tort liability or some other liability exposure, partners in a joint venture need to plan for risk exposures after the specific goals of the venture have been achieved.

The contractor should consider taking the following actions when assessing the coverage once the joint venture ceases:

- Arrange for copies of all liability policies to be kept into perpetuity.
- Identify whether extended reporting periods or "tails" will be purchased on claims-made policies and who will negotiate and pay for such coverage.
- Determine at the beginning of each joint venture who will be responsible for claims made after the conclusion of the joint venture relationship.

In Texas the statute of repose—which establishes the overall time limit for products liability actions—is 10 years. While the statute of repose specific to construction projects is designed to limit the period in which legal action can be brought after construction is completed, it still may run beyond the warranty period.

Understanding the risk exposures during every phase of a joint venture is critical to the success and profitability of the relationship for all co-ventures.

Achieving Success Through Collaboration

Joint ventures are a good way to grow a construction business, particularly when dealing with large and mega-projects. If both parties of the joint venture agree to do their homework before entering into the agreement—and understand the benefits and pitfalls of the relationship and work collaboratively to achieve common goals—then they will be successful.

Going forward, Texas' construction industry is expected to continue on an upswing. Companies that enter into successful joint ventures may improve their chances of landing large and lucrative construction bids in this upbeat construction market.

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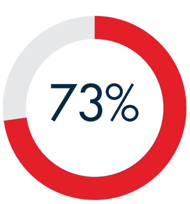

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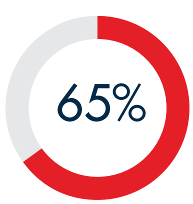

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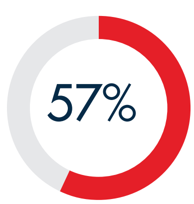

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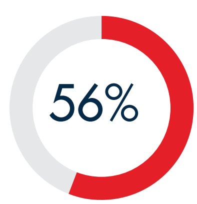

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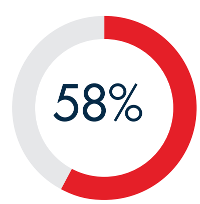

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