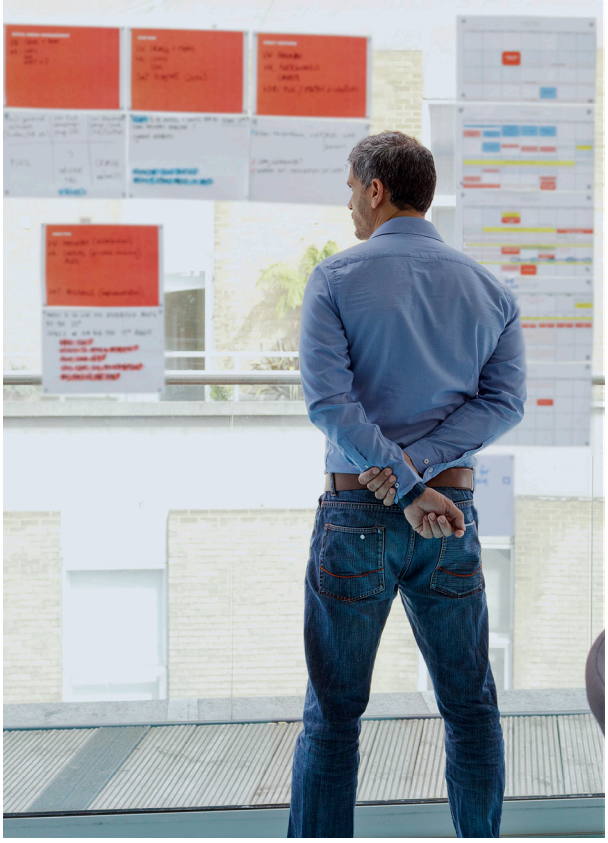
Project Selection Discipline Yields Better Performance Outcomes

By Will Gruy and Tyler Paré

Contractors and construction services firms had a banner year in 2021. While the COVID-19 pandemic continues to affect global commerce in unprecedented ways, the built environment experienced less demand impact than initially feared at the outset of the outbreak.

Many contractors are poised to have record years in terms of project awards and construction put in place and have backlogs that are near historic highs as they enter 2022.

During the height of the pandemic-fueled uncertainty of 2020, many construction firms abandoned discipline around their strategy and project selectivity. Any backlog was considered good backlog, as there was no telling what the impacts of the pandemic would do to long-term construction demand. With a surprisingly quick rebound in demand for construction services in 2021, and ample uncertainty around supply chain and delivery factors



sustaining into 2022, a return to more disciplined project selection behaviors may be warranted, if not overdue.

Why Project Selectivity?

Selecting the right work is one of the most important and consequential management activities in an at-risk construction business. Contractors' profit margins are greatly influenced by the quality of their project selection process and decision making.

While it may be obvious that good backlog equates to good financial results, the downside of risk of poor-quality decision making in project selection is asymmetric. That is, one or a few bad projects can wreck an otherwise profitable year.

Contractors' most profitable years are often ones without any major losses. Thus avoiding catastrophic projects is key to achieving best-in-class profitability, and requires the discipline to say no to opportunities with identifiable issues.

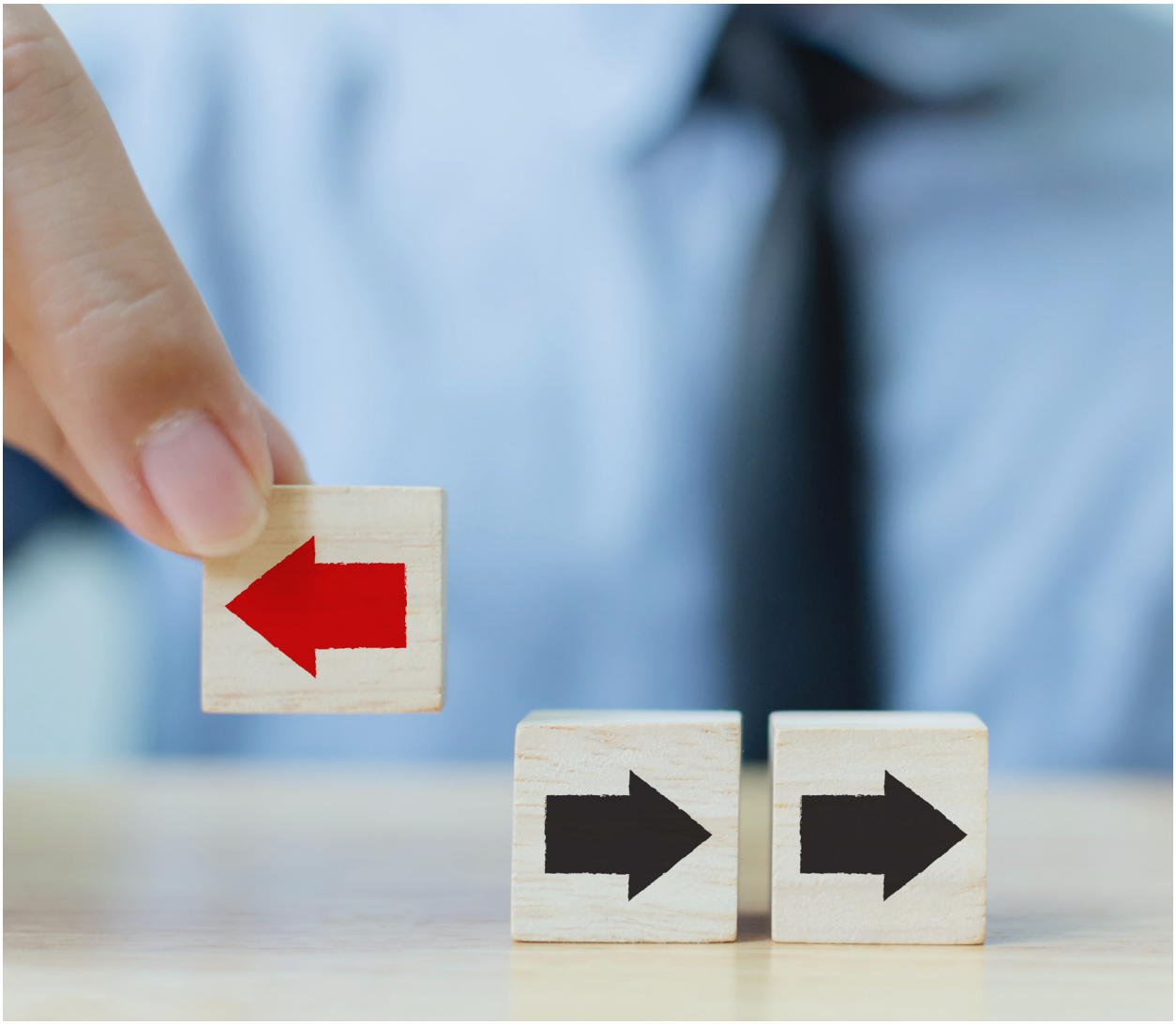
The Discipline to Say No

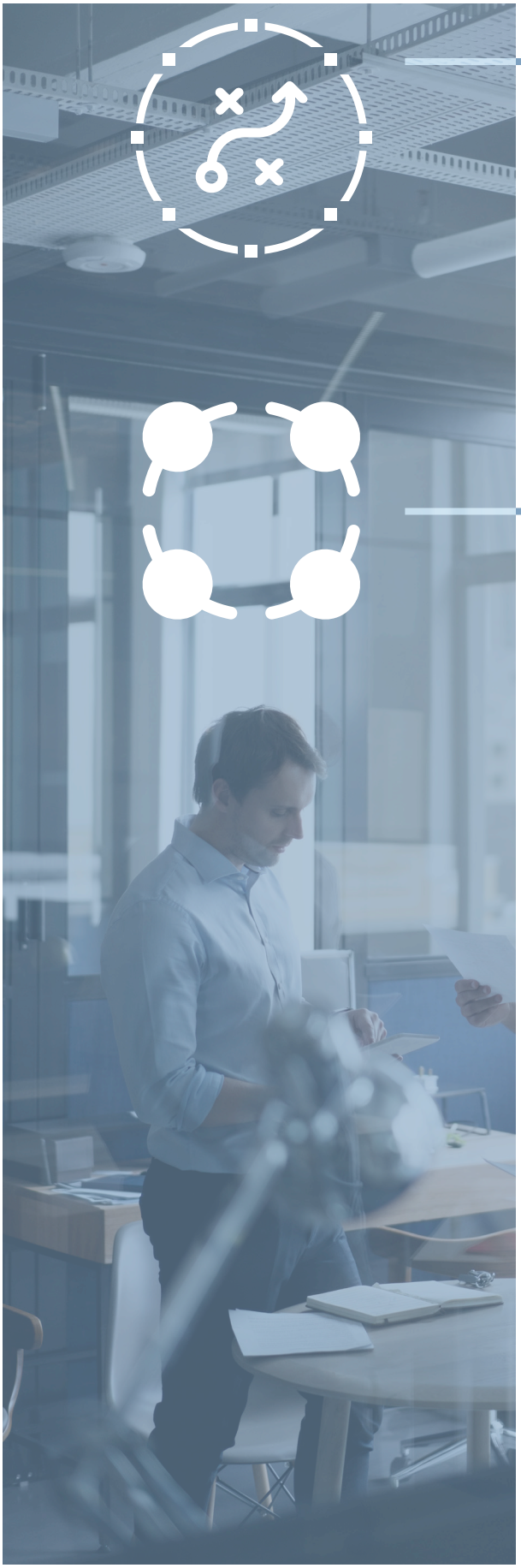
Contractors have a hard time saying no. This is largely driven by a scarcity mindset inherent in a project-based business with an ever-evaporating backlog and no guarantee of future work.

However, in FMI's experience, the most discerning contractors relative to project selectivity are invariably the most profitable. That is, those that have the discipline to say no to marginal opportunities and say yes only to opportunities with high probabilities of success end up with healthier backlogs and more profitable financial results.

The discipline to say no starts with a shared understanding of the project characteristics or factors that generally lead to positive (or negative) project outcomes. From there, work acquisition teams should evaluate these factors before beginning to pursue a job or submitting a bid.

There are seemingly endless factors to consider when deciding whether or not to pursue a project. However, below are a few of the major factors that are consistently associated with project success.





Strategic Fit

Understanding whether a project aligns with or advances the enterprise strategy presupposes that there is a clear strategy at the beginning. But the high-level parameters of a company's strategic framework should be one of the first filtering criteria for project opportunities. Does the project align with the segments, clients, delivery methods and geographic footprint in which we've chosen to compete?

Customers

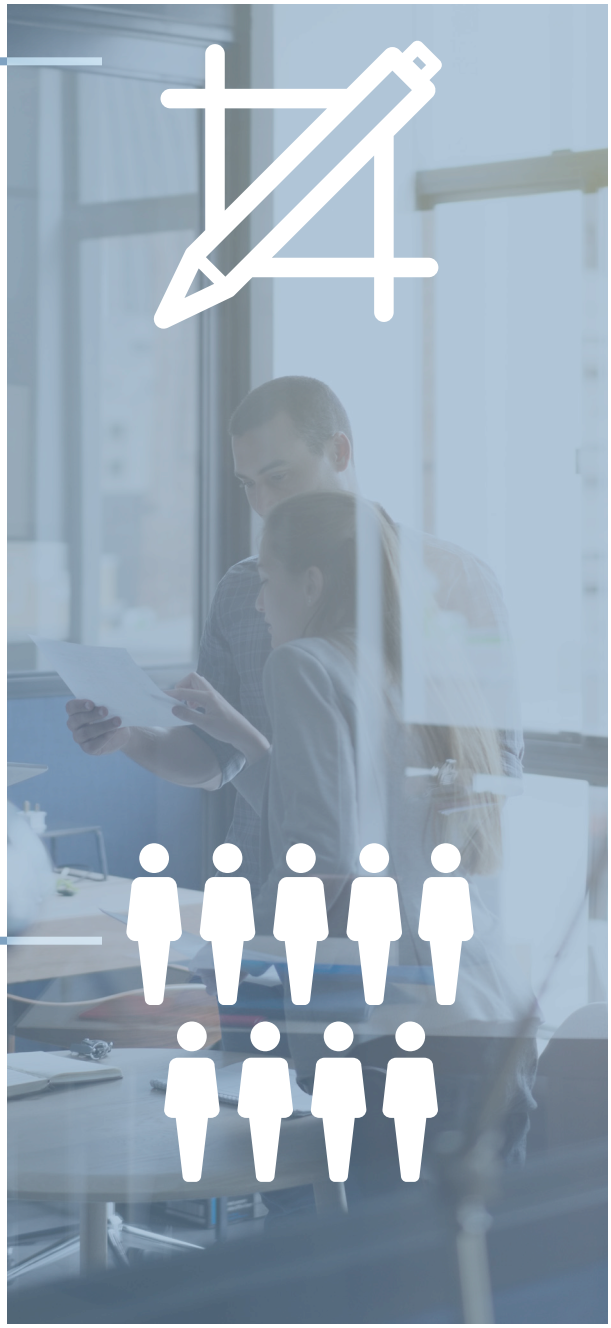
The depth and strength of customer relationships influence the probability of project success. Direct experience or industry reputation offers insights into what it will be like to work with a particular customer. Things to consider include:

- **Selection:** How will the selection process occur? What are the primary criteria for selecting a contractor?
- **Collaboration:** How easy is it for us to work with this company and its processes or requirements? Is there a collaborative or adversarial worldview on contractor management?
- **Customer team:** Have we worked with this client team before, and, if so, what do we know about its strengths and weaknesses?
- **Customer's customer:** If we are working for a general contractor or a developer, do we know the end-user client? Who is ultimately going to pay the bills on the project? What is its experience with construction? With the general contractor? With the developer? With us?
- **Financial stability:** What is the ability to pay or the reputation to pay on time?

Design

A contractor's ability to be successful on a project is almost certainly tied to design. Many agree there's been a steady decline in design quality over the last decade. Contractors must assess the quality of design or their ability to influence the design during the pursuit phase:

- **Quality:** What is the current state of design and design quality?
- **Stakeholders:** Who are the main designers and consultants? How receptive are they to input?
- **Design influence:** Based on the delivery method and the stakeholders involved, what is our degree of confidence that we can influence the design in a way that allows us and the project to succeed?



Resources

The scarcest resource in the construction industry is experienced, qualified people to manage and deliver work. Not having the right people to manage the work presents huge risks to a contractor. Yet, projects are often pursued and secured in the absence of proactive workforce planning and consideration for who will develop and run the work.

- **Delivery capacity:** Do we have the right team for the job?
- **Pre-planning:** Does our team have enough time to be deeply involved in preconstruction, estimating and pre-job planning?
- **Return on resources:** Will this project generate the right profit margin, given the labor, supply and project management resources that it will likely consume?
- **Opportunity Cost:** If we take on this major job, what resources will we be tying up and for how long? This means we will not be able to pursue other potentially more attractive opportunities for a period.

Additional key factors to consider:

- **Early involvement:** When did we get involved in the opportunity?
  - How many conversations have we had with the client about the project before it became a real opportunity?
  - Have other stakeholders (potentially competitors) been involved in preconstruction advisory in any capacity?
- **Project location:** Is the job in our current work area or outside our geography? If outside of our typical jurisdiction, what risks need to be considered, such as labor (craft and professional), local government agencies, project controls, per diems and other factors?
- **Competitors:** How many other competitors are involved in the pursuit? What do we know about these companies and their track records?
- **Commercial terms:** Are we familiar with operating under the terms stipulated in the contract? Are there certain clauses or provisions we need to be aware of relative to change management, payment or other stipulations?
- **Economics:** What are the gross margins we expect to be able to price into the job and to realize, preserve or maintain throughout the execution?

Develop Selectivity Factors

FMI strongly encourages firms to develop a bespoke set of selectivity factors unique to their organization and strategic context. These factors, commonly referred to as go/no-go criteria, should be aligned with the competitive strategy and informed by past experiences.

- **Strategy alignment.** When firms build a strategic plan, they identify several objectives regarding market position, customer base, type of work and financial goals. By implementing a more structured go/no-go process, companies can ensure that each project is furthering the strategic plan and not simply plugging holes in the backlog and generating small margins.
- **Experience context.** The past is a good indicator of the future. We highly encourage contractors to regularly examine their historical project performance, filtered across some or all of the factors referenced above. This should inform which project scenarios have yielded the best (and worst) outcomes for the company in recent years and should influence future pursuit decision making.

Factors Working Against Selectivity

When projects go bad, there is often rationalization or justification for the outcome, such as "We didn't have our best team on the project, and the client was difficult and unfair." But in reality there are invariably a multitude of factors identifiable in the pursuit phase that signaled substantial risk on the project.

If these factors are identifiable, why are they ignored? Pursuit selectivity often breaks down for one or more of the following reasons:

- **Emotion:** Contractors fall in love with a project.
  - It's in our backyard.
  - There's no way we can let our competition take this job.
  - This is our best client; we must bid the job.
  - This would be the biggest job in our history.
  - This is a marquee project for our market, and we want our company to be known for building major jobs like this one.
- **We need work:** Contractors identify a hole in their backlog and feel that an acquisition of a major project, regardless of risk, will go a long way toward filling that gap.
- **Unbridled growth:** Contractors can become intoxicated with growth and take on increasingly more work, abandoning risk management discipline.

Having some semblance of process around project selectivity goes a long way to removing emotion and shortsighted impulse from decision making.

Process Basics

Driving consistency around project selectivity requires some amount of process or documented activity flow that outlines how a company or division will objectively evaluate project opportunities. If your organization is seeking to adopt more rigor in its project selection approach, below are a few basics that may help you get started.

The first step is to align around the critical factors that are predictive indicators for your company's success on a given project. We have outlined several examples earlier in this article, but these factors should be amended to address your specific strategic context.

Second, establish an objective scoring rubric to evaluate each factor. This can be a numeric attractiveness scale of 1 through 5, green/yellow/red, or any other discrete method of scoring. The important thing is to keep it simple and easy for everyone to understand. You may also apply a weighted scale to factors you deem more important or significant than others. The scoring of multiple factors should produce a summary or composite score, which could be compared against a perfect or ideal score. You may also establish certain composite score thresholds that an opportunity must meet to move forward in the process.

When a pursuit is evaluated against the defined factors, it is ideal to have multiple evaluators score the opportunity independently. This mitigates the risks of group think or having one individual assert too much influence over the process. Scores can then be compared and debated to reach a final consensus. Teams may also want to clarify who has ultimate decision-making authority relative to pursuit selectivity in case the evaluation team reaches an impasse.

While a consistent process and objective evaluation tool are helpful, firms should not follow the output of the project selectivity process blindly. The process tool serves merely as a foundation for establishing facts and objective information about the opportunity. Critical thinking, expert opinions and industry experience must still be brought into the decision-making process.

To take the selectivity approach to another level, consider creating a multistage review process to determine if a project will be pursued. The number of stages is often driven by the size and the complexity of a project. We recommend developing a minimum of two stages:

- **Stage 1:** Should we pursue this project and dedicate resources to the pursuit? That is, does it align with our decision-making criteria, and do we have a high likelihood of winning the work?
- **Stage 2:** After gathering more information and refining our view of the project's attractiveness, should we move forward with a formal proposal response or bid?

Just because resources have been committed for estimating, preconstruction and proposal development does not mean that a formal bid or proposal is required. This is particularly true if the context changes, such as not having the resources to execute, or discovery of new information about the project.

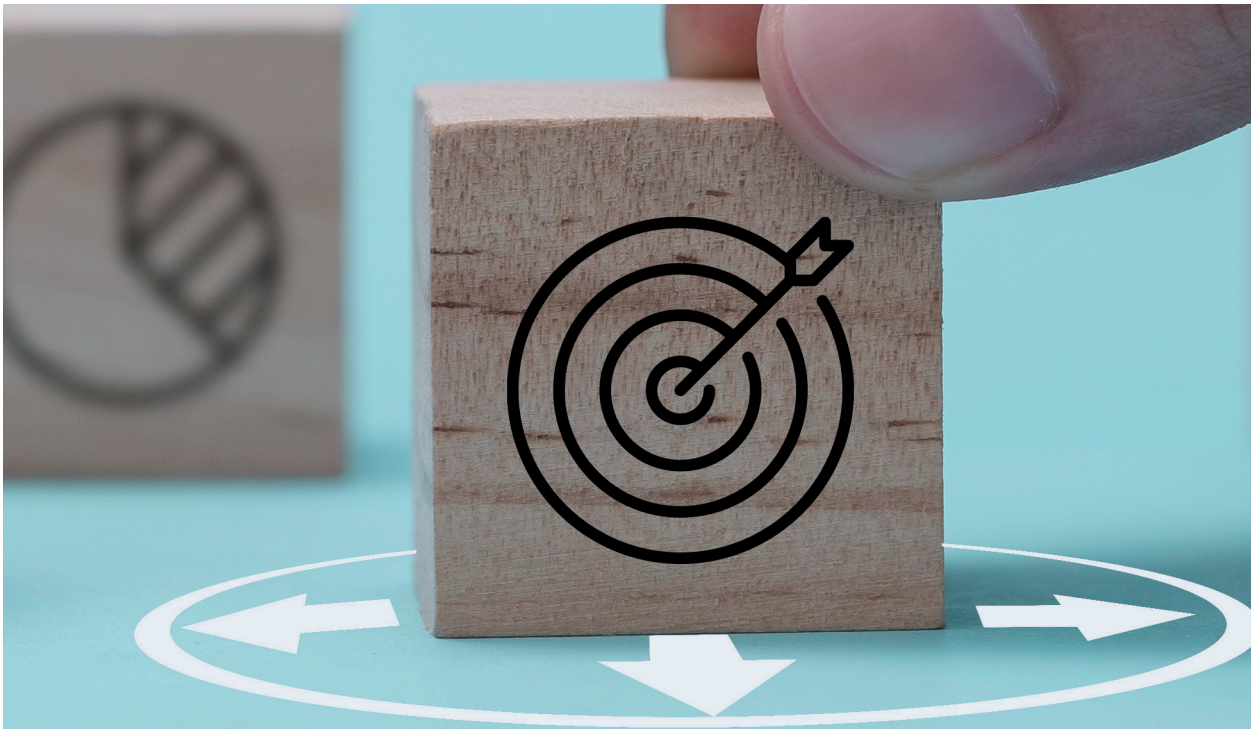
If the job turns into a significant risk due to new information uncovered during the pursuit phase, it may be better to kill the deal, eat the pursuit costs and move on, as opposed to potentially losing substantially more money in the construction phase. Do not fall victim to chasing sunk costs.

Rarely will a project perfectly match all the criteria. Often there are some good characteristics and some bad. If a pursuit is given a green light, then the factors that may cause problems should be given additional scrutiny and strategies developed to mitigate those risks. Equal focus and energy should be channeled toward maximizing the factors that are in the organization's favor.

The same is true when selectivity filters result in an initial no-go decision. If there's dissention in the ranks about the outcome, it's incumbent upon those in favor of the pursuit to develop a strategy that works for the business, both in terms of likelihood to win the job and for it to be a commercial success. These project win strategies then serve as inputs to future rounds of project selectivity and go/no-go decision making, which can continue to iterate based on the proprietary process or the size and complexity of the pursuit.

As volumes and backlogs increase, so does the individual project risk to your organization. The statistical risk of taking on a bad job increases with the size and number of projects. Sophisticated project selectivity controls can help manage this risk and make balanced, objective pursuit decisions. With ample opportunity and risk on the horizon, now is an ideal time to reevaluate your project selection discipline.

This is the first in a two-part series about choosing appropriate projects for your team. Watch for the second article in the next issue of the Quarterly.



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