



In The Midst of the Dot.com Shakeout

By Michael Anello, Contributing Writer

A few years ago, one of the most significant challenges facing construction professionals was keeping track of the horde of vendors offering technology solutions to the market. In the pre-dot.com shakeout days, hundreds of companies secured venture capital (VC) funding and entered the AEC (architecture, engineering, construction) market hawking solutions designed to help builders and contractors complete projects more efficiently and cost-effectively in a collaborative environment.

Today, the industry landscape is significantly different as the dot.com collapse has hit the construction industry pretty hard. Now the challenge for members of the AEC community is much the same: keep track of an unpredictable vendor community where numerous companies have closed their doors, become the targets of merger and acquisition activity or managed to survive the tumultuous market.

Clearly, this is no easy task. Rumors about the financial health of various technology vendors run rampant, but are usually impossible to confirm. If a company reduces the size of its executive team or lays off a significant portion of its workforce; is it struggling to stay afloat or preparing for a merger or acquisition? The answer is rarely apparent.

Of course, some degree of shakeout was expected following the activity in the marketplace nearly two years ago. Industry experts agreed that the market did not require and would not support more than 200 vendors, many offering nearly identical solutions. But the high degree of uncertainty regarding the future of many vendors coupled with the demise of several other firms has made it difficult for construction companies to make important decisions about technology adoption and implementation.

Indeed, the ongoing merger and acquisition activity in the construction community has had numerous negative ramifications. But veteran industry participants and observers point to less-obvious positive results. In fact, many of them forecast some type of silver lining emerging when the dust eventually settles.

Understandably, industry participants want to know how to resolve today's questions and challenges and, at the same time, attempt to predict the future of the market. But the ability to do so hinges on understanding the events of the past two years. Crucial to this understanding is an appreciation of the forces that drove much of the merger and acquisition activity: a significant downturn in the economy, the dot.com shakeout, and Wall Street dynamics. Coupled with this understanding is an appreciation of the rationale for these mergers and acquisitions.

Scott Unger, CEO and founder of Constructware, Alpharetta, Ga., explains that the most tangible force, beyond the obvious economic downturn, was the “bursting of the Internet bubble.” The utopian view of the Internet, which led many people to believe that enormous amounts of time and money could be saved almost magically, gave way to the harsh reality that these rewards could not be realized overnight, Unger maintains.

Carl Bass, CEO of Buzzsaw.com, San Francisco, Calif., recalls when every company was racing to have an Internet presence and engage in e-commerce—a period that seems like only yesterday. As executives at many large companies recognized the expense of doing business on the Internet, many of them gradually returned to their core competencies, Bass points out.

In addition, many of the dot.com companies that entered the AEC market simply had the wrong business model. In fact, many of these firms had little or no understanding of the unique relationships upon which the construction industry is built.

Take, for instance, the “build-the-stadium” business model. “So much money was spent building the stadium and subsidizing admission,” says Al Marshall, vice president of sales and marketing for Meridian Project Systems, Folsom, Calif. Although no signs of revenue were apparent, Wall Street rewarded that model—and then it stopped, he says.

Financial woes

The financing and structuring of many AEC technology vendors was another problem. BuildNet, Durham, N.C., is a good example, illustrating the weaknesses inherent to “rollup” structuring—especially when coupled with financial strategies that lacked adequate capital.

John Wagner, BuildNet’s former director of communications, says the concept of a synchronized supply chain for homebuilders was first voiced by Keith Brown, BuildNet’s chairman. BuildNet began as a software company named BuildSoft in October 1996. In May 1999, BuildNet acquired four leading providers of contractor-management software systems: TomSystems, Duluth, Ga.; FAST, Redmond, Wash.; Lloyd’s, Logo Vista, Texas; and TrueLine, Walnut Creek, Calif. These were the first acquisitions that led to the 11 constituent companies comprising BuildNet.

In early 2000, BuildNet acquired the Homebuilder software system from J.D. Edwards, Denver, Colo.; and UniLink Group LLC, Atlanta, Ga., which was renamed BuildNet Portal Group. And, in April and August of 2000, it acquired NxTrend Technology Inc., Colorado Springs, Colo., and HomeStyles, St. Paul, Minn.

BuildNet was attempting to assemble a completely integrated electronic supply-chain network. The aim of this ambitious enterprise was the creation of a completely seamless system that connected disparate platforms. However, problems with the rollup structure ultimately arose when convertible equities used for many of the acquisitions eventually came due as cash (since BuildNet never acquired IPO status on the market), forcing BuildNet into a defensive posture of bankruptcy to protect the value of the core software products.

Many of these companies reverted back to their original owners, and others are being sold at a bankruptcy court auction to satisfy creditors in Chapter 11 proceedings.

For BuildNet, the business model was problematic because its “product” existed across 11 companies. In addition, any of the companies acquired with convertible equities was a weak link.

Moreover, the associated risk involved with any potential venture capital was elevated eleven-fold because of the inherent fragmentation. BuildNet was also considered unattractive for acquisition because of the large debt associated with some of the constituent companies.

Yet, it is prudent to remember that the rampant enthusiasm on Wall Street in the early dot.com period made ambitious enterprises such as BuildNet seem like reasonable financial endeavors. Indeed, the financial community has played a significant role in the events of the last 18 months, says Unger. "Venture capital investments tend to last 12-18 months—(venture capitalists) don't want to fund a company for five years," he points out.

Additional funding is usually provided if companies show a profit after 12-15 months, Unger continues. However, most of the AEC dot.coms did not turn a profit in that initial period and, quite predictably, most venture capitalists pulled out.

Unger explains that this was the case in the merger between BidCom and Cephren to form Citadon, San Francisco, Calif. BidCom and Cephren were established by raising a large amount of venture capital funds. Consequently, there were high expectations for return on these investments. Thus, venture capitalists forced the unlikely merger of the two companies, whose functions mirrored each other, Unger maintains.

The huge influx of venture capital money followed by little return on investment has made the AEC market less attractive for investors, says Buzzsaw's Bass.

"After \$1 billion of venture capital was invested into this market with no positive returns for any of the investors, I don't think you'll see any new investment in the space from the financial venture community," maintains Bass, who expects that existing companies will expand their product offerings but few new vendors will spring up.

While the VC community is not likely to fund additional startup companies anytime soon, it appears willing to invest in more established firms. For instance, in March, Constructware received \$4.1 million in venture capital funding from Cordova Ventures LLC, Atlanta, Ga., to help accelerate its expansion and improve its financial depth.

Unger says his company did not require the funds to stay in business; rather it sought the money to increase the size of its staff, especially the development team.

Constructware received the money at a time when it was very difficult to raise VC funding. But having a presence in the AEC market made it easier for Constructware to garner the financing, Unger says. "The only companies who can raise money are the ones that are successful," touts Unger. "It's very difficult to do."

The firm has raised a total of \$10 million in VC money since its inception, reveals Unger, who adds that the employee-owned company does not plan to seek additional funding because it dilutes the ownership. As part of the transaction, Cordova's president became a member of Constructware's board of directors.

Another established player in the market, Hard Dollar Corp., Tempe, Ariz., also received a second round of VC funding earlier in the year, securing \$12 million in May. The estimating and project-management software developer sought the money to expand its development, sales, and marketing programs and to support a worldwide expansion program through Hard Dollar International. Hard Dollar received its initial round of \$11 million in financing in February 2000, which was used to initiate its multiphase plan to create an online operations hub for the infrastructure contractor.

The companies that have gone out of business typically fall into one of two categories: small companies that were privately funded, and companies that were consortiums of a variety of industry players.

Reasons for failure

“While venture capitalists pulled the plugs on many of the large consortiums, small, private companies may have failed for many reasons ranging from bad business plans, failed execution, financing or market downturn, and the economy,” Bass explains.

Many business plans were predicated on healthy adoption rates that never materialized, adds Unger. The industry thought that by throwing money at adoption you could dramatically grow the market, he says. Of course, marketing dollars that filled trade shows created awareness. However, “You can’t buy market adoption,” says Unger, who adds that it could be 5-8 years before the majority of construction companies switch to the Internet.

Most industry observers believe that the rationale for mergers and acquisitions is fairly obvious. It is also tempting to see only the negative consequences of this activity. However, examining the timeline and underlying rationale of M&A activity may be warranted in order to understand all of the consequences—which are both positive and negative.

Meridian’s Marshall explains that the early acquisitions of AEC software companies occurred in an attempt to capture revenue streams, expand Internet integration or build a customer base. Later acquisitions were designed to gain efficiencies, stay afloat or salvage investments. Mergers and acquisitions also took place so that companies could obtain e-commerce functionality because Wall Street was demanding it.

Indeed, this activity also reflects the whimsical nature of Wall Street. Buzzsaw.com was initially spun out from Autodesk, San Rafael, Calif., because a fast-paced, independent dot.com business model was attractive at the time. But Autodesk reacquired the collaboration vendor in July because that same business model was no longer being rewarded on Wall Street, says Marshall.

The reacquisition of Buzzsaw.com is probably beneficial for its customers because Autodesk is likely to keep the product, since the CAD (computer-aided design) vendor does not market a similar product, Marshall says.

In fact, Buzzsaw.com customers see the acquisition as “the best possible thing that could have happened,” Bass says. Customers who had worried about Buzzsaw.com staying in business have been reassured, and they recognize that there will be greater integration between Buzzsaw.com and Autodesk products. “This is one of the things customers are asking about,” says Bass.

Others predict further absorption of Buzzsaw.com into Autodesk. “Everyone is asking how much longer Autodesk will continue pumping money to keep Buzzsaw alive,” says John Jurewicz, an industry observer and the director of e-procurement for McClier Corp., Chicago, Ill. Jurewicz speculates that Buzzsaw.com might continue to be absorbed into the Autodesk toolset so that only subscribers to new versions of AutoCAD, Autodesk’s flagship product, will have access to Buzzsaw.com products.

The acquisition of ContractorHub by WinEstimator, Seattle, Wash., is one example of a vendor adding significant functionalities that it did not formerly possess. ContractorHub actually built something of real value, and WinEstimator made an educated decision that the assets were there to justify the purchase, even though the company had gone bankrupt, says Bass.

Indeed, Jurewicz points out, “most insiders in the industry felt that ContractorHub was one of the most mature e-commerce ASPs (application service providers) in the industry.”

More recently, Intuit Inc., Mountain View, Calif., announced plans to acquire OMware Inc., Sebastopol, Calif., a provider of business-management software for construction companies, for a price of up to \$42 million in Intuit stock.

The acquisition is part of Intuit's new "right for my business" strategy, which is designed to better address the needs of small businesses by providing customers with solutions that are tailored to their specific companies.

"One of the ways we will execute our strategy is to acquire companies that have developed proven business-management solutions for specific industries," says Steve Bennett, Intuit's president and CEO. "OMware is a perfect fit. The company has focused exclusively on providing the right business-management solutions for construction companies."

OMware's flagship product, The Master Builder, helps builders and contractors perform accounting, estimating, job costing, and project-management tasks. Intuit, meanwhile, is a leading provider of financial software and Web-based services. Its flagship products include Quicken and QuickBooks. Approximately 300,000 QuickBooks customers are in construction-related businesses, says Bennett.

Intuit plans to operate OMware as a separate business run by Dan Smith, OMware's founder and CEO, and will continue to offer its products and services under The Master Builder brand. Smith founded OMware in 1980, and now the company has approximately 4,000 customers.

Consequences, opportunities

Now that the construction industry has witnessed a significant shakeout in the collaborative market, the question becomes: how can participants shield themselves from the consequences or take advantage of new opportunities?

Marshall advises potential customers to do their homework before selecting a vendor. For instance, ask whether a company is an acquisition or merger target and what this activity could mean, he advises. Additionally, Marshall cautions customers to look for real products, not promises, and to examine the number of users and levels of satisfaction. He recommends staying away from offers that sound too good to be true.

"You're probably better off paying more for products (because) you want to do business with someone who knows how to operate profitably," he says.

Obviously, the BuildNet example illustrates what can happen if you become involved in companies with overly ambitious goals. The lesson here may be to avoid companies without focused aspirations. However, industry observer Tim Beally, a senior vice president for design firm 3D/International, Houston, Texas, cautions against choosing vendors with too specific a focus as they may not accumulate enough customers to be profitable. Beally says that the downturn in the economy will hasten M&A activity. But he also warns that such activity is not linear and can often catch you off guard.

The interconnective nature of the collaboration industry means that many vendors rely on the solvency of other companies that provide servers and hardware. Jurewicz says that attention should be focused on the health of companies such as Exodus, Santa Clara, Calif., the largest data-hosting center in the industry. Bricsnet, Portsmouth, N.H.; Buzzsaw.com; Citadon; and eBuilder, Gainesville, Fla., all host their data with Exodus, he says.

Jurewicz adds that his company does not trust servers and backs up all of its data. He says GE Power Systems, Fairfield, Conn., and the New York Times, New York, N.Y., the largest users of Citadon, use their own servers because of this skepticism. He notes that collaboration companies

could start partnering with large telecommunications companies for stability. Examples of this are Meridian Project Systems, who has already partnered with Qwest, Denver, Colo.; and Primavera Systems, Bala Cynwyd, Pa., who has partnered with Intel Corp., Santa Clara, Calif.

More specifically, in October 2000, Intel Capital made an equity investment in Primavera to aid the development of PrimeContract, Primavera's e-business solution for the AEC market. The move followed an investment in Primavera by i2 Technologies, Irving, Texas. Together, the investments by i2 Technologies and Intel represent a 21.7% ownership in Primavera.

Primavera decided against spinning off PrimeContract as a separate company. "We wanted to build value in Primavera," says Joel Koppelman, the company's CEO. "In all the dot.com craziness, we decided not to do it. We're trying to build Primavera. The best way to do that is to keep it as one company."

What does it mean?

In general, it is advisable to revisit the historical forces that caused the events of the past 18 months. Customers should consider how further economic downturns might affect certain vendors, to what degree vendors are subject to the dynamics of Wall Street, and whether they possess adequate financial reserves. In addition, customers must determine if a vendor's business plan is based on unreasonable adoption rates, and if the vendor's scope of functions is too ambitious or too narrow? Similarly, these same customers must take responsibility for finding out if a vendor's business model is profitable and if it is focused on the short-term or long-term.

Mergers and acquisitions are nothing new. Outside the AEC community, the activity is common; and in most industries, their meaning is transparent. Jim Summers, local IT manager and former landscape architect at Einhorn, Yaffe, and Prescott, Boston, Mass., says that the mergers and acquisitions in the AEC collaboration market are less obvious. Especially as you move away from the owner's perspective, there is less understanding of the implications, he says.

Summers suggests that owners are more suited for making business assessments of M&A activity. As you get closer to the individuals who are actually designing and building structures, there is decreasing understanding of the ramifications, he says.

"These people are focused on the day-to-day work," Summers says. On the contrary, an owner may have better insight into the ramifications of these business developments. As a result, owners may be less tentative about choosing a vendor and more confident in their decisions.

Positive, negative results

For the AEC collaboration market, the intense merger and acquisition activity will have lasting consequences, both negative and positive. Overall, this activity promotes a wait-and-see attitude regarding the adoption of technological solutions, says Marshall, who explains that customers are sensitive and anxious about the selection of vendors.

Industry observers say that declining competition will slow progress on much-needed innovations such as XML (extensible markup language) technology and other solutions. Bass agrees, saying that with the disappearance of Buzzsaw.com's chief competitors, the firm has been left without competition, which is not good for innovation.

For the customer, there are many negative outcomes. Some customers have been forced to migrate to new solutions after being abandoned by defunct vendors, while other customers have transitioned to revamped solutions after their vendor was acquired. Still others, at the mercy of vendors on life-support, anxiously await the final outcome. Some jump ship of their own accord.

Perhaps it is hard to imagine, but there are some positive ramifications stemming from M&A activity. Beally explains that before the collaboration market was thinned, it was difficult for vendors to know what to provide customers. “The vendors left standing are reinforced because it reflects what the market wants,” says Beally.

With more room in the market, trends in user satisfaction and activity will be more evident. Beally believes that another positive result will be less emphasis on developing nonessential innovations, which will allow customers to choose between real solutions. With less money to go around, vendors will be more prudent about spending resources on new gadgets. The quickly developing market was a moving target for most customers—perhaps the fallout will gradually allow customers to better understand the market.

Indeed, the experience has caused more customers to give greater attention to evaluating the vendor, says Unger, who views this as a positive outcome. The process of evaluating vendors can take months, says Unger, who adds that most customers do not evaluate vendors effectively and are stupefied by the fallout.

The activity has not helped customers who are having a hard time deciphering one vendor from another, Marshall says. He notes that more customers are asking to review vendors’ financials to determine if they are going to be around for a while. Most will share information under a nondisclosure agreement, he says.

Marshall adds that mergers and acquisitions may be beneficial to customers because of the additional complementary features that may result from bringing new companies into the fold. In addition, he points out that it is advantageous for the customer to not have to deal with as many vendors.

Perhaps some of the fears and uncertainty have been transformed into constructive developments. For instance, the recent launch of GradeBeam, Chicago, Ill., indicates that some members of the construction community are taking proactive measures against the uncertainty. Gradebeam is a builders’ exchange for the Chicago area that was founded by the five of the largest general contractors in Chicago: Walsh Construction, Pepper Construction, W.E. O’Neil Construction, Graycor, and Bulley & Andrews.

Jurewicz notes that GradeBeam is run by members of the construction community, as opposed to software vendors or technicians. Although only a few months old, the builder exchange appears to have tremendous traction because services are inexpensive and there is already an established community, built by construction industry members. In Jurewicz’ opinion, these types of exchanges may be the wave of the future, since local Internet hubs coupled with local hosting centers can equate to improved downloading and uploading speeds—which is extremely crucial to the rapid exchange of drawings.

The future

Overall, the architectural, engineering, and construction market will end up being healthier as a result of M&A activity, industry experts and observers agree.

As Marshall puts it, “There are some short-term prices to pay, but in the long run, I think it will be a better place for everyone—vendors and customers.”

It is not over yet, however, many believe. “A lot of fallout has happened, and there is still a little left to go,” Unger contends. Perhaps the initial phase of awareness is giving way to some nuggets of wisdom, especially if that wisdom amounts to caution as opposed to skepticism.

In the end, customers, analysts, and industry insiders agree—far from being simply another aspect of the Internet bubble—the enhanced productivity resulting from collaborative solutions is a real and tangible phenomenon.