

# Examining Market Share Trends of Texas Home Builders

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This paper examines market share trends of home builders within the state of Texas. Data for this research was obtained from the recently created Texas Residential Construction Commission (TRCC). The data base is the first of its kind in the State of Texas and contains information from 26,663 builders who registered with the state, as well as information regarding every registered new home built or significantly remodeled during 2004 and 2005. The data suggest there is unequal distribution of market share among home builders in Texas. A large share of residential construction in Texas is performed by a few publicly traded builders.

**Keywords:** Home Builder, Residential Construction, Consolidation, Market Share

## Introduction

Historically, homes throughout the United States have been built primarily by a high number of small regional builders. Within relatively recent years, a growing proportion of homes have been built by large, national builders. According to the National Association of Homebuilders (2007), the ten largest builders have experienced a market share increase in residential construction from less than six percent in the early 1990s to approximately twenty three percent in 2006. This market share increase has occurred, in large part, through mergers and acquisitions of local and regional builders. These growth mechanisms are contributing to changes in the structure and nature of home building in the U.S.

This paper examines trends in the Texas homebuilding industry related to market share and consolidation of residential contractors. Data for this research were obtained from the recently created Texas Residential Construction Commission (TRCC). The data base is the first of its kind in the State of Texas and contains information from 26,663 builders who have registered with the state, as well as 264,470 registered new home or renovation projects. This paper will discuss the changing pattern of builders' market shares in Texas, the role of mergers and acquisitions, and the current and future implications for the industry in Texas.

## Research Problem

The purpose of this research is to study the market share distribution of home builders in Texas in order to identify current and future trends in the Texas homebuilding industry.

## Review of Related Literature

This section reviews literature related to mergers and acquisitions with the purpose of identifying incentives and disincentives offered to homebuilders wanting to expand their market share. There is an abundance of peer reviewed literature analyzing the post effects of mergers and acquisitions (M&A). Choi and Harmatuck (2006) examined the actual operating performance of the M&A transactions observed from 1980 through 2002 in the U.S. construction industry. They tracked operating performance for three years after the integration of firms. Choi and Harmatuck found that the level of synergistic gains, measured by operating cash flow returns, was not improved significantly after firm integration. Their study also revealed that the size of firms dramatically increased after the integration of the firms while operating performance improved slightly. Finally, they learned that previous research findings concerning stock market returns on M&A transactions were consistent with the long-term operating

performance, thus supporting the market efficiency theory. Choi and Harmatuck concluded that public construction firms in the US, on average, have broken even with regard to their M&A activities and that managers tend to increase their own wealth rather than the wealth of shareholders. This study provides good insights for builders who may think that M&A transactions always lead to significant profitability growth.

Kaplan (1992) found that post-acquisition returns are positive to both the acquirer and the stockholder. He summarized that the market anticipates acquisitions, on average, to create value. Moreover, companies involved in planned consolidation gained more in market share than companies not participating in consolidation. Alberts and Segall (1966) studied corporate mergers and concluded that the objective of any merger program should be an increase in profits and not simply growth for the sake of growth. Ansoff, Brandenburg, Portner and Radosevich (1971) used Standard and Poor's Compustat Tapes to sample 271 companies which had at least one merger plan. It was observed that larger firms had better initial acquisition positions after mergers.

Healy, Palepu, and Ruback (1997) examined acquiring companies' cash flow performance after a merger in the fifty largest U.S. industrial takeovers from 1979 through mid-1984. The study focused on the acquiring company's accounting performance after the takeover and evaluated whether takeovers were profitable investments for the acquiring companies. Results indicated that the acquiring companies did not generate any supplementary cash flows beyond those required to recover the premium paid. Findings also revealed that friendly takeovers outperformed hostile takeovers; takeovers with payment of stock and debt outperformed cash transactions; and takeovers entailing companies with similar businesses performed better than those with unrelated businesses. Healy et al. found that company performance was enhanced due to higher takeover synergies and lower premiums paid to target stockholders. Finally, results indicated that strategic takeovers were profitable for acquirers, whereas financial transaction barely broke even. This study benefits homebuilders wanting to grow by providing insights about successful M&A characteristics.

M&A transactions are sought by some construction companies as a strategy for diversification. Choi and Russell (2004) studied 171 M&A transactions to examine the relationship between diversification and firm performance. They incorporated four qualitative diversification schemes in their analysis including: geographic expansion, increase of market share, vertical integration, and the conglomerate type of diversification. They found no significant performance improvement as a result of the qualitative diversification scheme. Choi and Russell did find that the relative size of acquisition had a significant positive impact on market returns. These findings help homebuilders to recognize that diversification strategies implemented through M&A transactions do not guarantee positive financial growth for a company.

There is a tremendous amount of peer-reviewed literature related to M&A transactions. M&A transactions do not always generate profitability growth for companies and their shareholders. However, when planned strategically, they can substantially benefit all parties involved.

## **Methodology**

In order to study the market share distribution, data were obtained through the Texas Residential Construction Commission (TRCC) describing home builders, new home projects, and renovation projects valued at over \$10,000 in Texas from January 2004 through December 2005. This information was organized and analyzed using graphs and tables to examine the market share distribution of home builders in Texas. This research provides a baseline towards understanding market share distribution and its impact on the Texas home building industry. A future longitudinal study can be conducted by incorporating annual data to this baseline information. Consolidation in the U.S. home building industry during the past decade was also examined. Finally, merger activity, sources of revenue, and market growth among the top builders in Texas were analyzed. Descriptive analysis of data collected was used to achieve the objectives of this baseline study.

## **Data Source**

The Texas Residential Construction Commission Act, which was passed through House Bill 730 during the 78th regular session of the Texas Legislature, called for the creation of the Texas Residential Construction Commission (TRCC, 2008d). This act requires residential construction projects, home builders, and remodelers to register with the State of Texas. The TRCC was given the responsibility for administering the registration process, overseeing the state-sponsored inspection and dispute resolution process, preparing and adopting limited warranties and building and performance standards, certifying third-party inspectors, overseeing task forces, providing a voluntary certification of arbitrators, and filing arbitration awards relating to residential construction (TRCC, 2008d). As of 2004, only two other states, Arizona and Oregon, had a similar state-sponsored dispute resolution process, while five states, California, Florida, Michigan, New Jersey and Hawaii, had some level of state-sponsored review of construction-related issues.

Effective January 1, 2004, all home builders and remodelers in the State of Texas are required to register their company and each home construction project with the commission. Builders and remodelers must submit a “Builder/Remodeler Registration Form” and a “Home Registration Form” for new homes; including all single family homes, duplexes and certain townhomes; remodeling projects involving interior renovations exceeding \$10,000; and, material improvements, defined as a modification to the home that either increases or decreases the home's total square footage of living space.

## **Data Collection**

Data for this study were collected from registration forms submitted to the TRCC. According to the TRCC (2008a), a builder or remodeler may not construct new homes or engage in remodeling projects that change the living area of the home or that cost more than \$10,000 for interior renovations in Texas without first registering with the commission. Builders must fill out a TRCC-promulgated “Builder/Remodeler Registration Form” (TRCC, 2008a). This form requires builders to provide company information including legal name, address, phone number, fax number, email address, business type, primary business activity of company, assumed names used in residential construction, names of all builder partners and their percentage ownership, other company affiliations of the applicant, and designated agent criminal and financial history information.

The TRCC also requires a “Home Registration Form” to be submitted for every residential construction project under their scope (TRCC, 2008b). Builders and remodelers must provide registrant information, the residential construction type, the filing date, the construction project address, and the homeowner's mailing address. Data obtained from registration forms was inputted into a database for analysis.

## **Research Findings**

The research findings are divided into two categories: “Research findings from the analysis of Texas Residential Construction Commission Data” and “Inferences from study of acquisitions and mergers in the U.S. home building industry with a concentration on Texas.”

### *Research Findings from the Analysis of Texas Residential Construction Commission Data*

From January 2004 through December 2005, 264,470 residential construction projects and 26,663 home builders were registered through the TRCC. Data indicate the Texas residential construction industry has a large number of small contractors, but large, publicly traded homebuilders control most of the market share. Figure 1 illustrates the market share of the top 10% of builders, which consists of 2,666 contractors. The top 10% of builders in Texas captured 92.51% of the total market share, leaving 7.49% of the market for the remaining 90% of builders. The top 100 builders had 67.48% of the total market share of residential construction. Of the top 100 builders, more than 34% of construction projects were performed by the top 10 builders. The top five builders built 62,818 out of the total 264,470 homes, thus capturing almost one-fourth of the total market share. Home building companies in Texas

vary in size from large-scale production builders constructing over 10,000 homes a year to small builders constructing less than five homes per year.

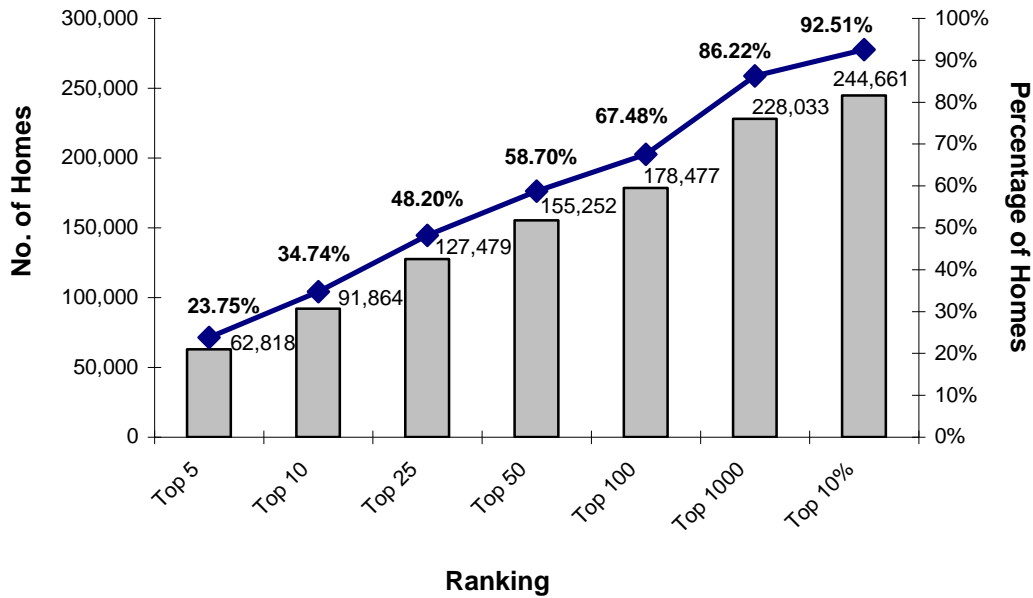


Figure 1: Builder Rankings and Percentage of Homes Built

Figures 2 and 3 show the market share distribution within the top 100 builders. 48.2% of residential construction projects in Texas were constructed by the top 25 builders, while 51.8% of the projects were built by 26,638 builders. Out of 178,477 homes built by the top 100 builders, 62,818 homes were built by the top five. This demonstrates an unequal distribution of market share within the top 100 builders.

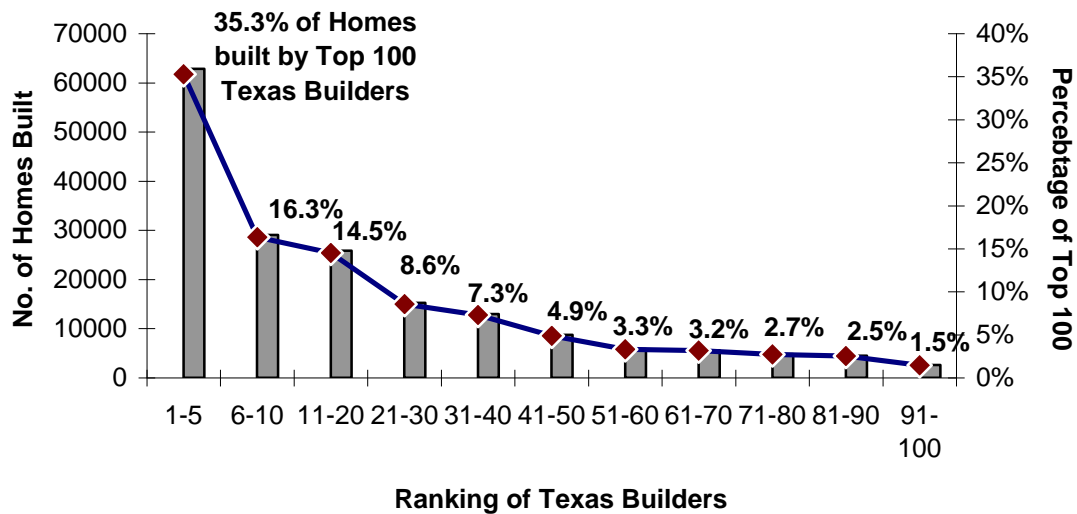


Figure 2: Distribution of the Market Share within the Top 100 Texas Builders

Figure 3 illustrates increases in the number of homes built in 2005 compared to 2004. The bar graph shows a significant increase in market share by the top 5 builders. These are the large, publicly traded builders that have shown evidence of consolidation. The graph indicates the market share for the largest five builders has increased by 30 percent in one year followed by a 25 percent increase in those ranked 6-10. The top 11 to 60 builders have experienced small amounts of market share growth and the top 61 to 100 builders have experienced minimal increases. The highest growth rates were among the top builders.

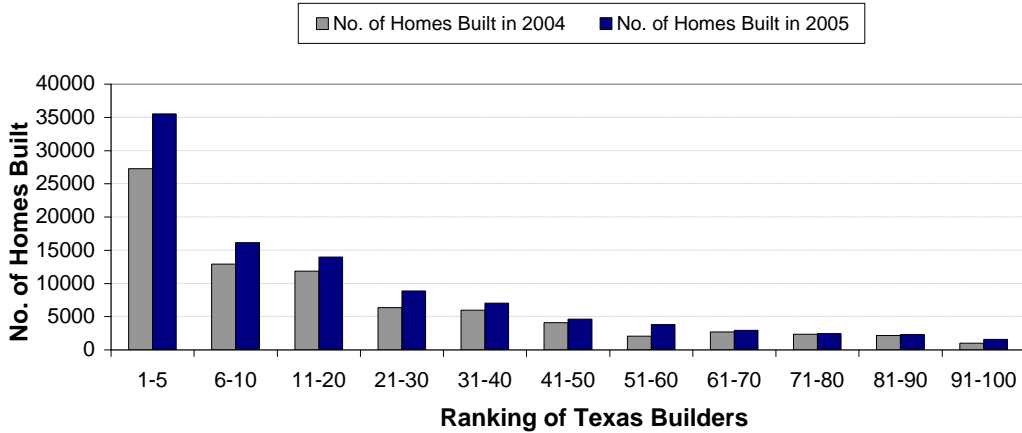


Figure 3: Market Share of the Top 100 Builders in Texas for years 2004 and 2005

*Inferences from Study of Acquisitions and Mergers in the U.S. Homebuilding Industry with a Concentration on Texas*

The U.S. home building industry has experienced much change in recent years. The market is still characterized by numerous small firms, but large production home builders have been increasing their market share dramatically. Figure 4 shows that the top ten builders have increased their market share from 8.8 percent of new home closings, in 1989, to approximately 20.9 percent in 2004.

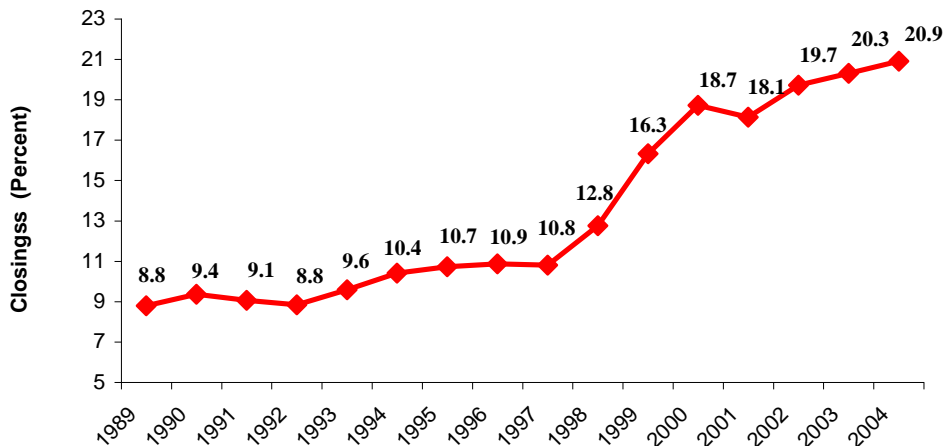


Figure 4: Market Share of top ten US home builders from 1989 to 2004

To analyze the role of mergers and acquisitions in the growth of large companies, a list of the acquisitions and mergers of the largest four builders in Texas was examined. The top five acquisitions, in terms of number of companies acquired in the last decade, were made by the top ten home builders. Figure 5 shows that the top builder

acquired 23 companies from 1993 through 2005. Annual reports of the top four Texas builders emphasize their strategy to diversify by acquiring local or regional homebuilders. The top four builders averaged over 16 acquisitions of smaller builders during this time period.

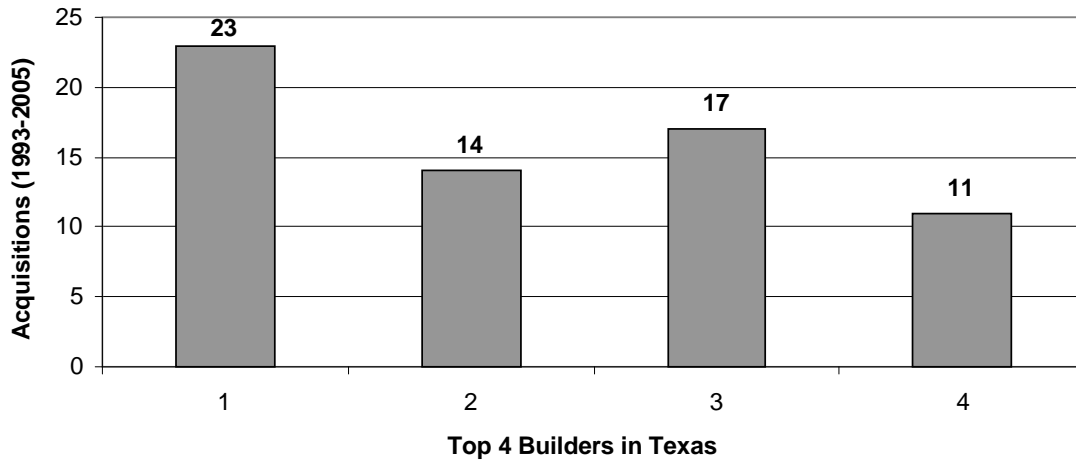


Figure 5: Number of Acquisitions among U.S. home builders from 1993 – 2005

Table 1 lists the sources of revenue and their percentage towards total revenue for the top four builders in Texas. The largest source of revenue is from home sales. Several of the publicly traded top four builders have acknowledged in their financial reports that mergers and acquisitions have contributed to growth in revenues among these companies.

Table 1

***Sources of Revenue among Top 4 Texas Builders***

<b>Ranking</b>	<b>Home Sales</b>	<b>Land Sales</b>	<b>Financial Services</b>	<b>Construction Services*</b>	<b>Home Services</b>
1	91%	3%	6%	-	-
2	97%	-	1%	2%	-
3	96%	2%	2%	-	-
4	76%	-	10%	13%	1%

*\*Covers range of contracting services including: construction management, general contracting, design-build, and pre-construction services*

*Source: Presentation by National Association of Home Builders, Research Economics Group*

Figure 6 illustrates TRCC data showing an increase in the market share of the top 4 builders in 2005 with the market share of the top builder more than doubling. Table 1 and Figure 6 can be analyzed together to conclude that only the very large firms, especially the top ten, are gaining market share while the remaining contractors have either a constant share or are losing market share.

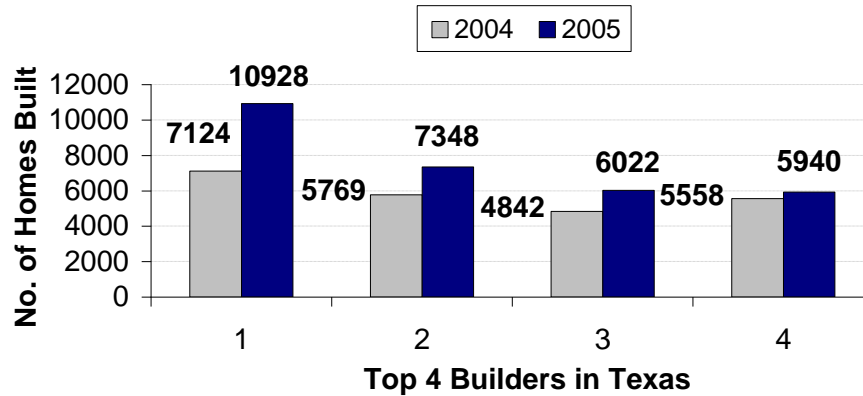


Figure 6: Market Share of the Top 4 Builders in Texas in 2004 and 2005

### Conclusion

This paper provides a unique glimpse into market share trends of Texas homebuilders. Information detailing 26,663 registered homebuilders and 264,470 construction projects in Texas, from 2004 through 2005, was obtained through the newly formed TRCC. The data suggest there is unequal distribution of market share among home builders in Texas. A large share of residential construction has been performed by a small number of publicly traded builders. Acquisitions of local and regional companies are a major contributor to the increased growth of the big home building companies.

Many large builders indicated through their annual reports they will continue to pursue growth through acquisition. Thus the economic environment for private home builders will continue to change in the coming years. The small builders will be forced to fight for their place in the market. Niche builders will continue to have a share in the market because of fragmentation of home building opportunities. Custom home builders and remodelers will retain their place for smaller and more specialized projects that do not attract the larger builders.

The consumer can benefit from consolidation trends. Large builders can offer lower pricing, faster deliveries, and uniform quality standards which are important factors for consumers. However, big builders typically offer fewer options and limit flexibility in design.

Most of the data in this study was collected during the expansion phases of the market cycle. The recent downturn could mean an interesting transition period for the home building industry. Some builders may use the downturn to acquire more regional builders, diversify geographically and accelerate consolidation for future gains, while other builders may focus internally on preserving margins and internal improvement.

This research is the first step towards exploring a research area with great potential. This study may be conducted at regular time intervals. This will give us a better insight into market cycles in Texas and consolidation patterns. The following questions have immense potential for future research that will benefit the construction industry: Is consolidation the demise of small regional home builders? Can consolidation be beneficial for smaller players in the market? Does market disparity fuel consolidation or is consolidation increasing market disparity?

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