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Contractor Planning for Uncertain Times

DENNIS ENGELBRECHT,
JOHN WOODCOCK,
AND WAYNE RIVERS

Family Business Institute, Inc.
Phone: 877.326.2493
info@familybusinessinstitute.com
www.familybusinessinstitute.com

PURPOSE

Contractors began 2020 with high hopes for another year of strong volume and profits. Current events have rapidly overtaken us, however, and 2020 now looks like anything but "business as usual."

Professional service firms, trade associations, and other sources were very quick to publish excellent and important information about contracts, tax law changes, the CARES Act, and other crisis-related topics. What was missing in the marketplace of ideas – until now – is the information you need the absolute most: HOW TO LEAD AND MANAGE your business in unprecedented and unpredictable times.

The purpose of this White Paper is to present, for the very first time, a tool you can use in real-time to precisely plot where your business stands. This info is coupled with advice and specific actions you can undertake to not only cope with the current environment but also to manage through and position your company for current and future success.

LEADERSHIP IN TRYING TIMES

In a manner of speaking, a crisis presents a clear call to action. Contractors in the CEO Performance Roundtable Program have shown a resolute clarity of purpose. This resolve was characterized by one member company which established its priorities for crisis management early on:

- Ensure the safety and well-being of team members
- Keep jobs moving forward for the benefit of customers
- Keep people fully employed

Leaders have communicated more, found new and better ways to deliver their messages, adapted to new ways of operating and found new – and sometimes very effective – ways to meet these challenges. They called upon their peers for best practices for instituting updated policies and procedures. They put ego aside and helped each other and the industry react positively to the situation. They demonstrated amazing leadership at a time when it is needed the very most.

Now What?

With crisis planning somewhat in hand – the news changes seemingly by the day – contractors must turn to mid- and long-term strategies that they must employ and strong leadership for keeping their teams together, positive, and productive. The Family Business Institute recommends approaching this challenge with three general imperatives:

- Make strong leadership your top priority
- Honestly assess where your company stands from financial and new business pipeline perspectives
- Implement strategies to cope and succeed through the coming changes in the construction economy

LEADERSHIP PRIORITIES

By studying successful leaders from hundreds of different businesses over long periods of time, we have identified critical behaviors necessary to successfully navigate difficult and uncertain times. They are as follows:

1. ***Lead strong.*** Get in front of your people often both in groups and individually. Your people will have questions about the future of your company and their own careers. You don't have to have all the answers; in fact, you can't! What you can do is acknowledge that people have anxiety and uncertainty these days, and that you recognize that fact and are developing strategies for ensuring a successful future

2. ***Develop strategies to preserve and build cash.*** The number one reason businesses fail is the lack of sufficient capital. Ideally, you go into this upheaval with strong capital and cash positions. You must fight to stay in a strong position to be able to maintain the support of your bonding and banking partners, subcontractors and suppliers, and maintain pay, benefits, and incentives for your employees

3. ***Stress test performance, cash flows and profits.*** Run models to understand your break-even level of sales and best, worst, and median or most likely case scenarios of profit performance. Measure how many days/months of overhead you have covered in cash and in backlog gross profit

4. ***Evaluate your organization, talent, and structure.*** You want to know that you are right sized for the challenges ahead and that you have the "right people on the bus in the right seats." Determine who you can't do without, those without whom you could manage, and what personnel cuts will look like should you need to make them. When the time comes for making these tough decisions, your rational, dispassionate analysis should already be done and ready for implementation

5. ***Stay close to your customers.*** A business doesn't exist without its customers, and continued customer service and relations are critical to short- and long-term success. Seek to provide more value and communication, not less, in this environment. While others may be stymied or even pulling back in reaction to the current challenges, work to differentiate yourself and add value with your customers

6. ***Evaluate and manage your trade partner and supplier networks.*** You will need these partners' support and excellence to deliver successful projects and get preferred pricing to win ever more competitive work in the future. Market to your trade partners in much the same way you market to your customers, and always add value

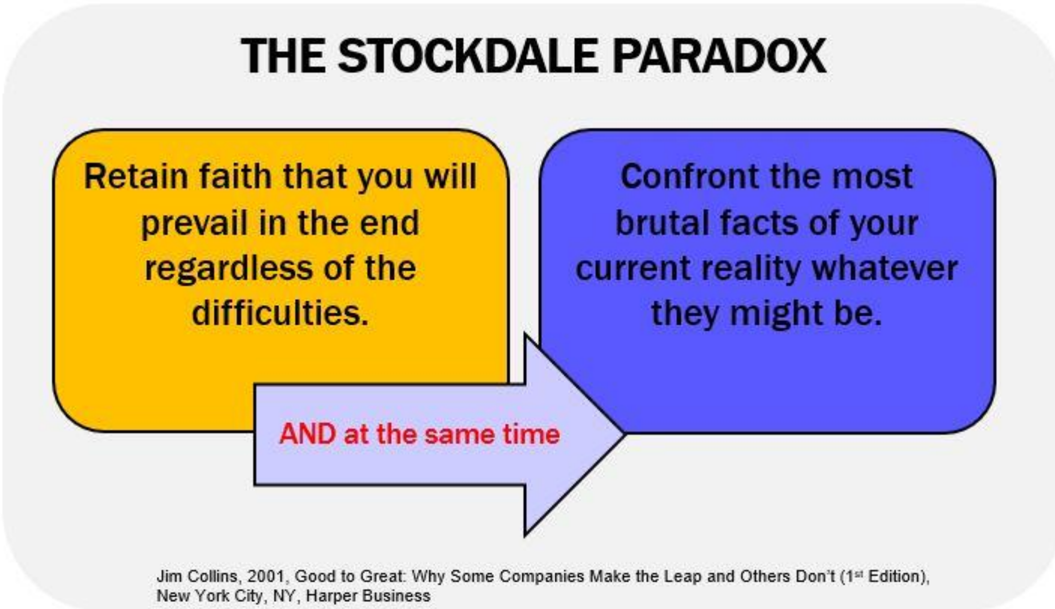
7. ***Assess your financial and market positions.*** Different companies come into this potential economic upheaval in various positions of financial and backlog strength. Depending upon your sectors and geographic location/focus, you may face a more positive or negative environment. Evaluate your position realistically and objectively so that you can attend to #3 above and plan effectively

8. ***Develop short- and long-term strategies based on your positions.*** The best contractors have done formal strategic planning and updated their plans regularly. Depending upon your individual company situation, plans may need to be changed and adjusted going forward. If you don't have a recent plan from which to start, developing one now is paramount to maximize your chances for success and to navigate current and future challenges

9. ***Make the necessary decisions and take necessary actions.*** Even the best plans are rendered useless if they are not executed swiftly, decisively, and with buy-in across the team. Good execution coupled with a clear path forward are essential for leading in troubled times

LEADERSHIP MUSTS: DECISION MAKING

Leaders, in uncertain times, must instill confidence among their teams as they face and make difficult decisions while simultaneously being brutally honest about their companies' positions. The Stockdale Paradox illustrates this perfectly:



Every organization relies on its leader's decision making. People take comfort in knowing that someone is steering the ship. That doesn't mean that a leader must make every decision or make them alone. They should involve others and solicit differing perspectives, seek additional opportunities for research, and test assumptions and alternatives. What they must NOT do is procrastinate. Deferring decisions generally leads to sub-optimal outcomes. It seems appropriate here to quote Bundy Bundesman, our colleague at The Family Business Institute: *"Construction is a tough business for tough people who make tough decisions."*

Your first priority in decision making must be to ensure your company's survival and success. If the company does not survive, then no individual's job, benefits, or incentives survive. If the company survives but doesn't succeed, it cannot offer longevity, opportunities, or rewards for your team, and the ability to service clients disappears. To ensure survival and success:

- You must run your work successfully. The delta between good job performance (write-ups) and poor job performance (write-downs) is potentially of much greater impact than any overhead cuts, brilliant new strategies, or company reorganization/realignment. You must keep sufficient and talented staff on the front lines and support them appropriately to achieve job success
- Many of the decisions you make will be about people. Companies with the best teams, top to bottom, will be the long-term winners
- Cash flow is critical, even for well capitalized companies – you can survive a significant downcycle if you can keep sufficient cash

- Decisions must be made in balance. Your business has no doubt built a great deal of positives over time. Don't "throw the baby out with the bathwater" by making rash decisions that unnecessarily sacrifice long term gains for short term financial results. Success and profitability, in construction, is best measured over the long term. Think about your business as a "perpetual business" (see *The Infinite Game* by Simon Sinek to further your understanding of this concept). From this viewpoint, short term losses may be an acceptable or even good strategy if they allow for the best pathway to long-term success

FOCUS YOUR LEADERSHIP

Preserve Cash Position

Navigating the current business cycle will test your tactical, organizational, and strategic leadership. All three areas are important, but most immediately put your focus on the tactical to ensure you have a good plan. Bring immediate attention to your cash position. Cash is always king, but never so much as it is when business has the potential to shrink, so pay attention to the critical cash drivers.

- Begin by ensuring your lines of credit are secure. Review the underlying agreements and terms. Understand any security or deposit requirements, rights of the lender to draw back funds, etc. It may be prudent, where possible, to draw some amount of the line now to have cash on hand, but each company's terms and banking relationships will be different

- Depending on the size of your business, you may have a substantial amount of cash on deposit. Bank balance sheets are significantly stronger than they were in 2007, but consider spreading deposits to maximize FDIC protection. As you realign cash and investments, ensure that you are considering the covenants and requirements of your surety arrangements

- Manage the working capital engine of your business deliberately. If you don't have a clearly communicated billing and collection process, stop now and put one in place immediately. Ensure your project management and accounting team follow the process with rigor focusing on any unique client or contractual billing requirements that might risk rejections or delays of invoice approval and payment

- Apply the same level of rigor to cash disbursements. Discontinue early pay programs; the small discount is worth far less than having the cash on hand for an extra 30 days. Continue to honor your contractual payment obligations, but don't pay sooner. As you make these adjustments, be sensitive to key supplier or subcontractor relationships. Don't make a significant adjustment to your payment practice without communicating "the why" to vendors or suppliers. Communicating thoroughly and honestly demonstrates your commitment to the relationship and may also inform you of some circumstances that influence how you manage that procurement. Maintaining the dialogue gives you the opportunity to get an early read on where a key trade partner or supplier might be feeling a cash pinch allowing you to respond proactively rather than react after a problem arises

- Manage your over- and under-billed positions carefully. Continue to bill as early as contractually feasible thereby accelerating cash flow. Remain aware that, as volume shrinks, a large over-billed position will require cash to fund. The working capital required to fund these changes are relatively easy to quantify. Ensure that your finance and operation teams spend time developing a forecast of the cash required in the final months of completing jobs with large over billings

- If you have any material capital investments planned, evaluate deferring those expenditures. Prioritize the most critical capital equipment needs. If an asset's utilization is expected to drop, consider selling it to generate cash and meet future requirements via leasing. Think carefully about opening that new office, or at least revisit your space plan

Revisit Your Forecast

The 2001 recession was short-lived, barely extending to the full two quarters of declining GDP that defines an official "recession." The recession following the 2007 banking crisis was long and deep. This time we all can hope for a V-shape dip and quick recovery, but we should have a plan for a deeper and longer downturn. This isn't succumbing to pessimism, it's being realistic, prepared, and prudent. With that in mind, develop a financial forecast for the next six-, 12-, and 24-month periods. Most well capitalized businesses can sustain short-lived downturns relying on existing cash reserves and modest adjustments to cost structures and plans. Longer downturns, regardless of capital structure and resources, require fundamental changes to strategy.

Many contractors rely on a time-tested forecasting model that can quickly be deployed for this purpose. For most, this will be something that has been created in Excel or a related software enabling quick changes and sensitivity analysis. If you don't have such a model, there are resources (your CPA or a financial consultant) that could quickly develop a basic tool to give you the ability to evaluate potential outcomes and scenarios. Whatever you use, ensure it is capable of projecting your future revenue streams across multiple periods (annually as well as monthly), gross (or project level) profit, overhead spend and any other income and expenses such as interest or insurance premiums, and profit sharing and other compensation programs. This tool will be vital in evaluating what your business may look like under different sets of economic and market circumstances. Work with your controller to evaluate and model different outcomes. These outcomes should reflect external changes.

- Evaluate contract backlog. What projects might slow or terminate? Consider owner's sources of funding. Examine awarded work not yet contracted and apply the same considerations
- Revisit your business development pipeline giving consideration to market sectors, how they've been impacted, and the potential for delayed start dates. How might your "win rates" be impacted as you compete for fewer available jobs?
- Re-evaluate margin potential. While contracted backlog margins may be secured, downturns shift leverage to construction buyers likely resulting in margin compression for most new work. Some sectors will experience more margin pressure than others. Use the experience you have from prior cycles to aid in your forecasting

Use your forecast to model your business under differing scenarios. In each scenario, evaluate what level of profit your business will generate from its operations. From here you can plan for the adjustments you may need to make to your overhead and the rest of your cost structure. Keep in mind this is an iterative process; one step informs the other. You may, for example, choose to forgo revenue that requires significant overhead resource support. Alternatively, you may elect to continue to carry as overhead several key superintendents for a longer duration because your analysis tells you that profitable opportunities requiring their skill sets are in your future. Regardless, your goal is to develop reasonable insights into what your break-even points are under different revenue and margin scenarios and over different durations. Be careful not to overanalyze! Consider the realities of your marketplace, your competition, your sectors, and ensure you have a baseline to plan from including a worst-case view to know what adjustments you need to make should things get really tough.

- Median case: This is your most likely scenario. This is going to look different from what you were anticipating only weeks ago. Adjust your business model to this case with clear actions planned should the case worsen
- Worst Case: This scenario assumes a longer downturn, broader economic impacts across sectors, and deeper impacts on backlog and margin
- Best Case: Planning for what you believe will be the most likely case and knowing what additional adjustments you will need to take should things deteriorate further will enable you to navigate the difficult challenges ahead. Once you have these insights you can consider whether you want to look at more optimistic or opportunistic scenarios

Adjust Your Organization and Cost Structure

Now that you have created some visibility into what the future operating environment will look like in terms of volume, margin, and gross profit, turn your leadership attention to your organization model and associated costs. If you expect the downturn to be short lived with minimal impact, you may need to make fewer adjustments than if your assessment indicates the risk of a prolonged drop in volume along with elevated competition. Depending on your scenario, you'll want to make immediate adjustments in your cost structure to operate effectively and continue to cover overhead spend and deliver bottom line profits that will sustain, rather than drain, your capital and produce cash.

Mark O'Donnell in a recent blog post advised using what he called a "reverse accountability chart." Ask yourself the question: "What would my organization chart look like with 10%, 20%, or 50% less revenue?" Consider where your median and worst-case forecasts indicate your business will be over the next six to 24 months. If you anticipate a 30% decline in revenue and an associated reduction in margin, how would you restructure your organization to operate in that environment?

Your "real-world" circumstances make this more difficult than simply erasing some boxes or moving lines on an org chart, so this is an important exercise. Consider what functions are no longer critical, what roles can be combined, and what capabilities and people are critical to your long-term success. Salary and other associated people costs typically make up about 70% of a contractor's overhead budget. Focusing on the hard choices in terms of people and structure will generate a much more meaningful impact on your bottom line and ability to sustain your business through the downturn.

Often, when business leaders initiate overhead reduction planning, they take the "proportional cut" approach. "Everyone, we need you to cut 15% out of your department." This is not the time to be "democratic." In fact, there may be some areas where you make no cuts at all. Perhaps, you have made a commitment to enhance your sales and preconstruction capability by investing in more sophisticated BIM or other virtual design and technology. You may need to cut deeper in other areas to enable you to sustain this critical investment. Think critically about how you may realign functions and roles to maintain your effectiveness but drive costs out. For example, if you have a marginal performer in your estimating group, you may choose to eliminate that position and ask a member of your project management staff to take on that role allowing you to simultaneously continue to price work, eliminate a poor performer, and keep a strong PM on your team until there is a project for him or her to manage.

Don't lose valuable time by deferring important decisions hoping things get better. Once you've analyzed the outcomes, make the decisions necessary and take action! Eliminating positions rather than making across the board salary cuts is usually the most effective tactic. By reducing head count, you are eliminating fixed payroll and burden costs that would remain using salary reduction alone. This is not a "one size fits all" approach! Headcount reductions often require severance and separation pay with real implications on cash. Nevertheless, they are fundamental to maintaining the environment of respect, trust, and care that you've built into your culture.

Where you decide to make headcount reductions, do so in a way that enables impacted employees to depart with dignity and continue to be a positive representative of your culture – one that they may someday rejoin. A larger reduction done early, rather than several small waves of reductions in force made with the hope that things will recover sooner, is a better approach. The former gets the organization through the down cycle sooner by allowing it to adapt to the new environment. The latter begins to feel like "death by a thousand cuts" leaving the remaining employees wondering when the next shoe will drop – and slowly grinding your culture down in the process.

Where reductions in salary are an appropriate option, start with yourself and your leadership team. Leaders of the best organizations make the first and biggest sacrifices. Bonuses and profit-sharing reductions are obvious areas for conserving cash and are easily communicated and understood. Annual salary adjustments can also be deferred for all but those employees advancing into bigger roles and assuming increasing responsibilities. Like most of your overhead budget, compensation levels at the end of a long expansion are elevated, perhaps even inflated, and most employees have experienced extended periods of regular pay raises. If communicated effectively, a temporary deferral of pay raises is well understood by most.

As you develop a plan to adjust your organization and its cost structure, don't ignore the rest of the overhead budget. Act fast where immediate cuts can occur. The good news is that, after long running economic expansions like the one we've experienced, organizations and their overhead budgets are typically full of non-critical spend. Eliminate lower value-added discretionary spending items. When things such as club memberships or season tickets are difficult to cancel given that they are long term commitments, consider moving them to a personal account or simply decide not to renew.

Your worst-case forecast coupled with an organization and cost model to support it will require contingent decisions that are much more difficult both in terms of cost impacts and the impact on your business and people. Do not avoid worst case planning! Ideally, these scenarios will remain worst case plans only and will never need to be implemented. But if things worsen, you will need to take action to ensure your business and what you've worked so hard to build can survive the cycle. Having a plan will provide confidence, clarity, and greater visibility for the leadership team during a time clouded by uncertainty. Without these fundamental planning resources, your opportunity for successfully navigating these challenging times, regardless of your market, can be limited.

IMPLEMENT A STRATEGY

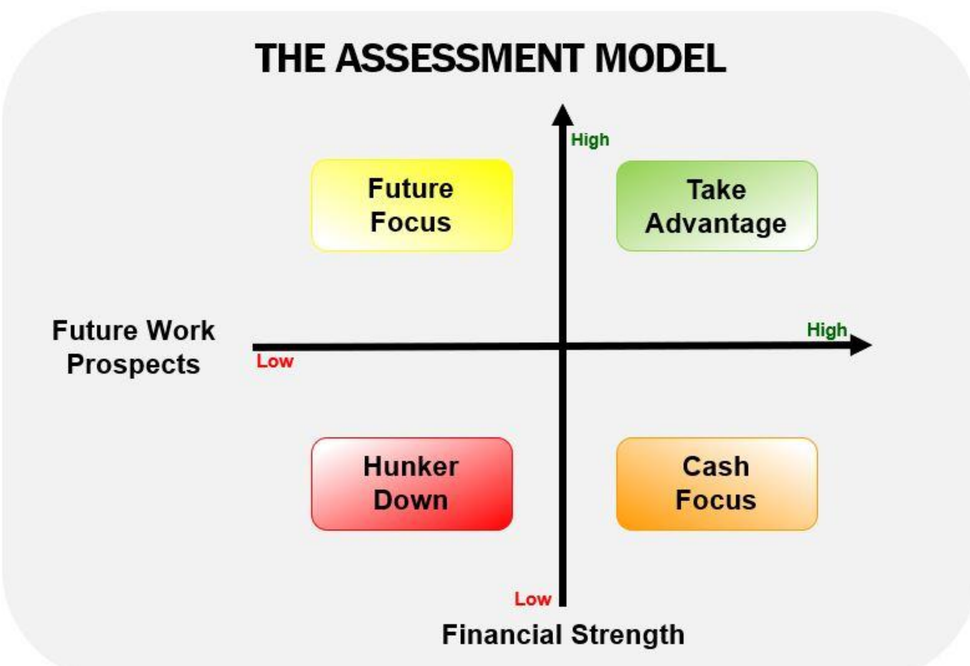
Strategy Depends on Your Company's Unique Situation

While all contractors find themselves in similar current event environments, each enters the situation in a different position with unique strengths, weaknesses, threats, and opportunities. Companies report pandemic impacts varying "from business as usual" to "everything is shut down and there is no end in sight."

As you evaluate your own company, consider the following:

Market(s)	Capital	Capabilities
• Market position • Backlog and pipelines of work. Likelihood of disruptions • Sectors and customers you service. Likelihood of disruptions • Niche customers or services. Likelihood of disruptions	• Equity position • Cash and working capital positions • Debt structure • Bonding and banking support • Succession plans/needs	• Leadership team • Preconstruction and design-build capabilities and team • Operational teams • Future leadership pipeline • Field capabilities • Technology platforms and capabilities • Training and development platforms/programs

The Family Business Institute is pleased to present a new tool to help you assess your specific condition and capabilities. You can use the tool and resulting assessment(s) to develop the right strategies to fit your company's condition and markets.



In assessing your position, evaluate your company across two axes on the model above. Depending upon your score, you will position your company in one of the four quadrants. There is a primary strategy for each quadrant which we describe in more detail later. The two axes are:

1. Financial Strength
2. Future Work Prospects

Financial Strength Scale

There are six categories for self-testing and rating, and they determine where you fit on the financial axis. The scale is one to five. Give yourself five points if your company is very strong, three if average, and one if your company is weak on that particular metric. Add your overall scores to plot your company in the appropriate place on the axis. If your score is 30, you'd be at the north end of the axis. If it's five, you'd be near the south end.

The table below includes various ratios (Revenue to Equity, Debt to Equity, etc.) that reflect the "normal" and median ratios for common construction trades. Use the table below to identify the construction trade that best matches your company's trade, then compare how your company's capital norms compare with those of other companies in that particular trade.

Capital Norms for Different Trades

(Source: RMA Annual Statement Studies 2019 and FBI, Inc. Benchmarking)

SIC Code	Trade		Revenue to Equity	Revenue to Working Capital	Debt to Equity	Sales to Assets	Operating Profit %**	Cash & Equivalents %
236220	General Contractors	Median	12.5	15.1	2.3	3	4.4%	22.5%
	Commercial & Institutional	Normal Range*	8 to 20	8 to 39	1 to 5	2 to 4	7% to 1%	36% to 17%
238220	Plumbing, Heating & AC	Median	8	12.4	1.7	3.2	5.6%	18.6%
		Normal Range	5 to 11	7 to 48	.8 to 6	2.4 to 4.3	7% to 2%	20% to 4%
238210	Electrical	Median	5	8.9	1.3	2.8	6.3%	16.9%
		Normal Range	3 to 7	6 to 22	.6 to 3.1	2.2 to 3.7	9% to 3%	23% to 6%
237310	Highway, Street & Bridge	Median	3	9.9	1.2	1.9	5.1%	20.8%
		Normal Range	2 to 5	5 to 26	.6 to .21	1.4 to 2.5	8% to 1%	31% to 14%
237990	Other Civil	Median	3	9.9	1.3	2	6.1%	16.1%
		Normal Range	2 to 5	5 to 31	.6 to 3.5	1.4 to 2.7	9% to 1%	30% to 10%
238140	Masonry	Median	4.5	9.8	1.1	2.8	6.3%	15.8%
		Normal Range	2.5 to 6	6 to 53	.4 to 3.6	1.9 to 3.8	13% to 3%	30% to 7%

* Normal Range reflects the upper quartile (stronger postion) to the lower quartile (weaker position). Generally speaking, larger companies can operate with a lower/riskier amount of capital than smaller companies

** Generally speaking, larger companies earn a lower average profit % than smaller companies

Rate your **capital strength** below; All ratings are on a one (low) to five (high) scale

	Capitalization - Lower multiples indicate a stronger balance sheet typified by sufficient equity:	**Your Rating (1 to 5)**
1.	Revenue to Equity	
2.	Revenue to Working Capital	
3.	Debt to Equity	
4.	Sales to Assets	
	Financial Performance - Higher percentages indicate an ability to maintain a strong balance sheet and cash flows through operations:	
5.	Operating Profit %	
6.	Cash and Equivalents %	
	Your Capital Strength Score:	

Future Work Prospects Scale

Like the Financial Strength Scale, use your scores to determine where to plot your company on the axis. Rate where you stand on each factor on a one to five scale with a five meaning "very strong" and a one meaning "very weak." Add your scores to see where you fall on the Future Work Prospects Scale. This scale allows for more subjectivity than the prior one, so be realistic – even brutally honest – in your evaluation.

	Future work prospects factor	**Your Rating (1 to 5)**
1.	Revenue (next three months) projected to run at or above last year's quarterly rate	
2.	Total backlog at or above historical revenue coverage rate	
3.	Sales pipeline of work at or near prior year level after considering impacts of economic slowdown	
4.	Industry: The sectors and markets where you work remain solid and do not project any material reduction in capital spending	
5.	Local and regional viability: The areas where you work remain reasonably strong versus experiencing significant negative impacts	
6.	Margin pressure – assess whatever your anticipated margins on new work will hold up. More than one or two percentage must be deemed negative impact	
	Your Future Work Prospect Score:	

With both scores in hand, plot your company's position on the model. If you are in or near one of the corners, your strategy is quite clear. If you are nearer the center point of either axis, you may borrow from your neighboring quartile – that allows for a sort of secondary strategy to supplement the primary one. Most contractors have developed their core set of beliefs (mission, vision, and values) and culture; keep them uppermost in your mind as you choose from the menu of strategies and tactics from each of the major themes:

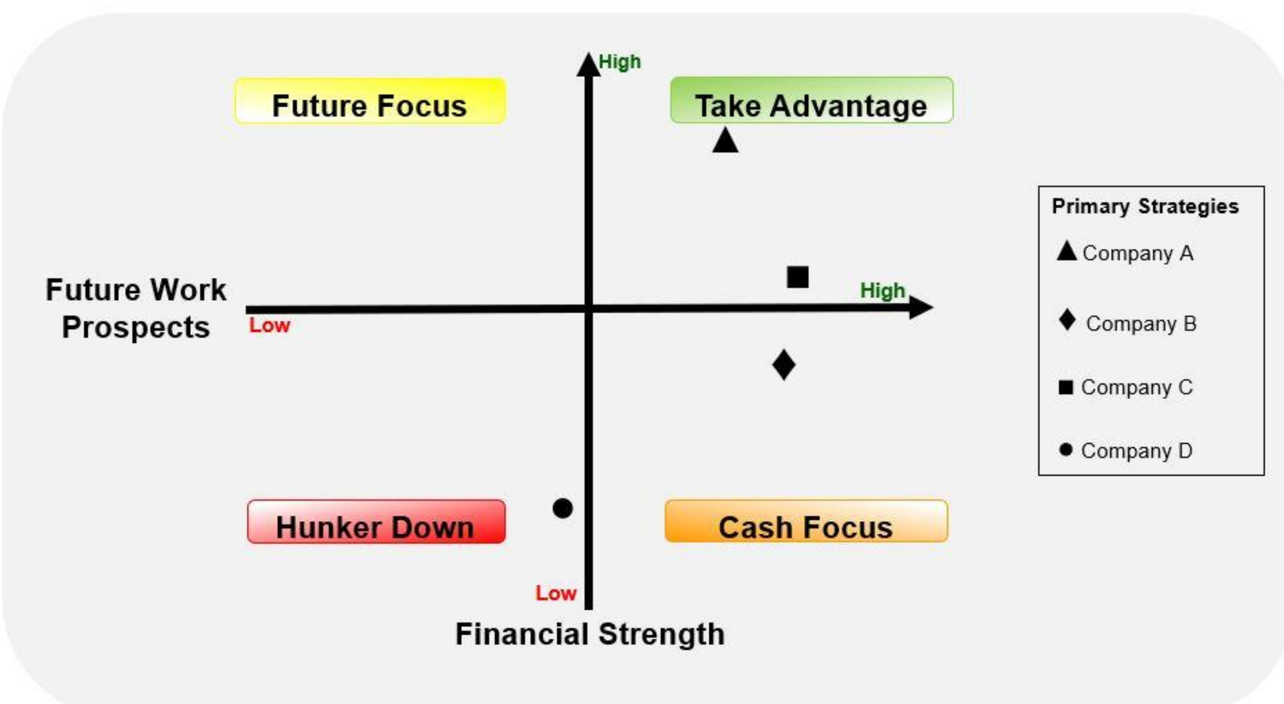
- **Take Advantage** – for companies with both strong capital and work prospects
- **Future Focus** – for companies with strong capital but weak work prospects
- **Cash Focus** – for companies with weaker capital but strong work prospects
- **Hunker Down** – for companies with both weak capital and weak work prospects

Let's look at four examples to provide clarity on how a company's leaders might use this model for strategy and planning purposes.

	Company A **GC w/35% Self Perform**	**Company B** **GC w/minimal Self Perform**
Capital Position:	Very strong capital position @ 17% of revenue. Cash position strong @ 13 months of overhead	Middling capital position @ 6% of revenue. Cash position also middling at 6 months of overhead. Good credit line facility @ additional 9 months
Backlog:	Good backlog, up 15% from recent norms. Gross margin in backlog is at top of market pricing. Largely govt. and health care focus	Backlog great @ 140% of last year's revenue, but vulnerable with high mix of hospitality and industrial. Projected gross margins are OK, but lost some in performance last year
Projects:	Forecast losing about 10% of 2020 revenue due to project cancellation or delay. Minimal lost time/revenue due to pandemic	Expect as much as 50% fallout of projects not yet started
Breakeven:	Breakeven is @ 70% of last year's revenue	Breakeven is 80% of last year's revenue
People:	Company was close to right-sized in past year, possibly a key body or two short	Company was a bit short on experienced talent, and inexperience cost some profit
Primary Strategy:	**Take Advantage**	**Cash Focus**
Secondary Strategy:	**Future Focus**	**Hunker Down**

	Company C – Mason	Company D – Mechanical Contractor
Capital Position:	Middling capital position @ 16% of revenue. Cash position weak @ 1 month of overhead. Some LT debt and substantial credit facility	Weaker than desired capital position with limited credit facility
Backlog:	Great backlog, up 15% from recent norms. Gross margin in backlog at top of market pricing. Diversified by industry and in multiple high growth markets	Backlog good compared to most years, but only 50% of annual revenue goal. Good industry mix, none in highly vulnerable sectors
Projects:	Forecast losing less than 10% of 2020 revenue due to project cancellation or delays. Minimal lost time/revenue due to pandemic, but potential impact or delays or cancellations is quite uncertain as is long term market strength	Lots of uncertainty about job delays or cancellation though nothing has fallen out yet. Couple jobs shut down for two weeks as part of pandemic response
Breakeven:	Breakeven is @ 60% of last year's revenue	Breakeven is 80% of last year's revenue
People:	Company has great team, always in need of additional mangers, skilled and unskilled help	Just got team where wanted and needed. Would hate to restart this process again
Primary Strategy:	**Take Advantage**	**Hunker Down**
Secondary Strategy:	**Cash Focus**	**Cash Focus**

Here's a look at where the example companies land on the assessment model:



STRATEGIC THEMES EXPANDED

Take Advantage

Theme: *Reinvest profitability. Solidify your team and your markets, and position yourself for market leadership and future success*

Characteristics: Companies in the Take Advantage quadrant are characterized by a history of success. This group has earned and sustained profits well enough to be able to meet capital needs and still retain plenty of equity in the company. They have excellent cash reserves so they can weather an economic hit whether from a recession, a slow spot in their workflow, a major receivables issue, or a temporary work stoppage.

They have been operating profitably with sufficient gross and net profits so they can make money even with decreased volume and margins. They usually reflect a break-even level that is about two-thirds or less of their normal volume.

They have succeeded in creating a good long-term backlog to ensure they have a long horizon in front of them in order to plan for – instead of react to – market disruptions. In addition, backlogs are diversified so a single owner, company, or sector problem won't derail them in the short term.

Strategy: The big advantage of this group is that the combination of strong financial condition and backlog allows the company to maintain strategies that are already in place, although the environment may dictate some adjustments. Take Advantage companies can support all their effective staffs (along with pay, benefits, and incentives), sustain its value-added proposition for customers, sustain initiatives for company improvement, continue excellent subcontractor/vendor payments, and sustain customer relationship/work acquisition efforts. They are also in good position to continue their long-term succession planning efforts.

While the natural instinct may be to cut to create greater efficiency in challenging times, companies in the Take Advantage quadrant should not give in to short term reactionary strategies and tactics. Instead, retain the good built up over the years and consider investing in new areas to enhance your firm's advantages. Look for some of the following opportunities:

1. Great people and teams are paramount to long term business success. A slowdown may offer opportunities to attract rainmakers, project managers, preconstruction leaders, and superintendents. Effective employees will likely not be the ones who are in the job market, but they could become available if other companies are protecting family members or making cuts based on which projects have concluded. Other superstar employees may have become disgruntled with the strategy, culture, leadership, and/or business succession planning of your competition.
    a. Look for employees who can raise your experience level in important sectors or those with potential client relationships
    b. Set aside an investment fund to maintain and reward current staff – keep your best together and provide room for future superstars
    c. Consider addition by subtraction – a softer economy may be a good reason to make those tough decisions you have been putting off. Necessary cuts are ones that enhance culture and morale, not hurt it

   d. Continue and even accelerate training and development. Many companies will have gutted training programs and stopped bringing on new project and field engineers. This may represent another opportunity for you to attract the best and brightest. If slower workflows create “excess time,” that can be a great opportunity to build skills and talent for the future

2. A potential slowdown may offer great opportunities to win new customers if competitors reduce their service levels as they tighten their belts. Additionally, customers who stop or slow down their work programs may be open to inviting others to compete when they resume. The competition’s best customers may be most accessible during tougher economic times

3. While slower times tend to increase competition, look for pockets of diminished competition – possibly on larger work as others are unable to secure bonding or are reducing risk

4. Focus on and sell your differentiation:

   a. Take advantage of technology innovations others can’t afford

   b. Provide higher levels of service than others

   c. Take advantage of your superior team and your ability to build better, faster, and safer

   d. Place your focus on customer relations. Customers may be tempted to seek more competition to get better pricing. Make a concerted effort to strategize how you can get lower costs for your customers without giving up too much fee. Make it hard for them to seek a broader market! Don’t presume your relationship is bulletproof; attack each relationship as if you were earning your first opportunity with them

5. Continue with succession planning and plans. Adjust valuations and terms of payment as needed to fit changing profit outlooks

Future Focus

Theme: *Don’t panic. Use your financial strength to keep your team in place and invest in efforts to build backlog and develop “lifetime customers”*

Characteristics: Companies in this quadrant are characterized by previous successes. They have earned enough profit to be able to meet all capital needs and still keep plenty of equity in the company. They have significant cash reserves so they can weather an economic hit whether from a recession, a slow spot in their workflow, a major receivables issue, or a temporary work stoppage.

They have been operating profitably with sufficient gross and net profits so they can make money even with decreased volume and margins. They usually reflect a break-even level that is about two-thirds or less of their normal volume.

Unlike Taking Advantage companies, Future Focus company backlogs and pipelines are not where they need to be to ensure prior levels of revenue and profit.

Strategy: The advantage for the Future Focus group is the combination of a strong financial condition and a performance history giving them the ability to look to the future and build/rebuild their backlogs. These strengths allow the companies to maintain most of their effective staffs (along with pay, benefits, and incentives), sustain value-added propositions for customers, sustain initiatives for company improvement, continue excellent subcontractor/vendor payment and relations, and sustain customer relationship/work acquisition efforts. They also may be in position to continue their succession planning efforts.

The big difference between the Take Advantage group and the Future Focus group is the more pressing need for gaining work and doing it at a reasonable margin. It is likely that backlog is soft and customary markets are not brimming with opportunities. Therefore, the focus needs to be on creating a profitable work flow in a changing environment.

Future Focus Companies: These companies need their organizations to come together around a comprehensive and sustainable work acquisition strategy. This will likely require one or more of the following three tactics:

1. Expand markets – expand the list of customers you are seeking to service either within your current geography or new ones, ideally focusing on your sweet spot type of construction, to avoid the high risk of combining these elements. Canvass your current and past lists of customers for geographic expansion opportunities
2. Diversify – attack some new sector(s) or construction type(s) that offer more or better opportunities, ideally in your same geographic territory. Assess your staff capabilities to see where you have personnel with the experience to lead these efforts from both sales and operations perspectives
3. Get more competitive to win more work
    a. Assess your opportunities to expand your reach of suppliers and subcontractors which is usually pretty easy in a changing environment
    b. Find reliable project partners who can help you get your pricing down and while offering reliable performance
    c. Work each bid hard to find at least three advantage areas where your team or your approach will allow you to get low without sacrificing too much fee
    d. Get low early! During any downturn, pricing will start to favor buyers of construction services. The fee you can earn today is most likely higher than it will be months from now. The earlier in the cycle you can build your backlog, the better. Take no solace in being second (unless you can salvage work from the second position due to other considerations); second brings in zero dollars in gross profit and employs no field resources! Know your market and do what it takes to win the work. Later in the recovery cycle, seek to avoid longer term commitments at lower margins as you will tie up resources that might be used for more profitable work that will come in the upcycle

Two warnings go with the advice above: First, don't do all three at the same time. Taking on new customers with new construction types and in new geographies all at the same time is a proven formula for disaster! According to Gregg Lyon of Travelers, one single job is responsible for about 70% of construction company failures. The financial strength of Future Focus companies should give them the capabilities to avoid this triple threat scenario.

Second, avoid taking work at margins too low for the sake of keeping people employed. Use breakeven analysis to help understand the margins required for keeping your company profitable, and find the combination of revenue, gross profit, and overhead to achieve breakeven or better.

Also consider the concept of acceptable losses. Your financial position may allow you to operate in the red for a short period of time in order to keep key team members on board for the long haul. During the great recession, a very financially strong contractor committed strategically to endure up to $1 million of losses, to keep its core team intact, and this commitment paid great dividends. The good news: because they operated throughout the downturn at breakeven or better, they didn't have to test their theoretical strategy.

Other suggested strategy/tactics for the Future Focus companies:

1. If there is a clear volume or margin reduction in sight, take advantage by culling your organization of poor performers - particularly those you feel might be detrimental to the culture you're seeking to build
2. Invest in training and development utilizing any "extra" time by developing and implementing programs to raise your future levels of performance
    - Maintain recruitment of and investment in project engineers, field engineers, and interns
    - Start building your team of the future
3. It's "all hands-on deck!" Business development is everybody's job!
    - Focus on building relationships and developing tomorrow's lifetime customers
4. Borrow tactics from the Taking Advantage strategies where appropriate

Cash Focus

Theme: *With a weaker capital position but good work prospects, nothing is more important than preserving and creating cash*

Characteristics: This group of companies is characterized by a weaker than average capital position and may or may not have enjoyed a solid profit model in the past. They have, however, succeeded in creating a good long-term backlog creating a long horizon in order to plan for – instead of react to – market disruptions. In addition, their backlogs are diversified so a single owner, company, or sector problem won't derail them in the short term.

Whether the company has opted to keep its financial position lean, or it was not possible to build a healthy balance sheet due to inadequate profits or succession demands, the Cash Focus company needs to ensure its financial well-being to be able to play the long game.

All other things being equal, these companies should be able to navigate successfully into the future so long as they don't have significant performance hiccups and are able to retain most of their earnings. They must also be able to replace backlog with reasonably profitable new work as they run off old work.

While a Future Focus company's viability is not immediately threatened, the future is not necessarily assured; caution is most decidedly warranted.

Strategy: A healthy backlog/pipeline allows a Cash Focus company to maintain strategies already in place, although if capital or cash positions worsen, that would demand a quick alteration of plans. The pipeline may allow the company to keep effective staff members (along with pay, benefits, and incentives), sustain its value-added proposition for customers, sustain initiatives for company improvement, continue good subcontractor/vendor payment and relations, and sustain work acquisition efforts.

The big disadvantage for Cash Focus firms is that there is limited room for error. The companies need to immediately undertake short- and long-term cash forecasting and breakeven analysis to ensure they don't need to take a more aggressive approach to cutting overhead. The company should be extremely frugal and eliminate any non-essential or non-strategic spending. Lower breakeven points can help ensure the accumulation of cash and equity. A clear contingency plan should be in place laying out the company's financial and organizational strategies.

Cash Focus companies must stay attuned to the impacts of project delays or cancellations which could threaten revenue forcing the company down to or even below breakeven. In short, the company can play the long game, but if the future cash outlook deteriorates, a quick pivot to the Hunker Down strategy would be necessary. Succession planning efforts should be delayed or altered as cash retention is the highest priority.

Cash Focus companies should emphasize the following:

1. Focus on executing work on hand successfully
    - Good work creates profits, and profits create cash
    - Maintain successful teams and execution
        - Maintain or create incentives for great project performance
2. Keep all capital in the company
    - Suspend or delay succession plans or payments as needed to build capital
    - Right-size owners' personal needs/desires for distributions until capital position improves
    - Delay large capital investments unless strategic gain is a sure thing and will provide a timely return on cash invested
    - Increase or draw upon credit lines to sustain cash flexibility

3. Use your performance and relationships on current work to help build your customer base, reputation, and business development for the future. Performance sells! So long as you are able to keep your team intact, continue work acquisition efforts to replace your backlog/pipeline as it is worked off

4. Borrow tactics from other quadrants where appropriate

Hunker Down

Theme*: With relatively weak capital and a challenging flow of work, getting to break even is a must and cash has to be maximized*

Characteristics: The Hunker Down group of companies is characterized by a weaker than average capital position, lack of a solid profit model, and a questionable backlog/pipeline of work. The Hunker Down company lacks the financial well-being to be able to play the long game and must focus on the short run.

These companies must figure out how to navigate successfully into the future so they can live to play another day. Even if a company's viability is not immediately threatened, its future is hardly well assured. Thus, caution and decisive action are warranted.

Planning to execute work at or above breakeven is paramount. Profit is the only cure for weak capital, so the company must operate in the black. Understanding your breakeven position and the factors that impact it are critical. The company might even need to develop capital strategies to stay in business if things get really tight. Follow the recommendations in the following sections to ensure you are hitting on all cylinders with regard to cash and working capital to both stay in business and retain sufficient bonding capacity to work your way to a better place.

Strategy:

1. Manage cash flow to buy time to survive and build a profitable backlog
    - Solve core profitability threats and rebuild balance sheet
    - Retain all distributions, and reduce tax deposits to expected profit levels for coming year
    - Exercise potential sale of long-term assets
    - Use various credit opportunities to secure additional operating cash and improve working capital for bonding
    - Overbill to the extent feasible without upsetting payment approval and flows
2. Focus on the "Hedgehog Concept" equation that defines success for the commercial construction industry: Gross Profit – Overhead = Profit
    - Project your monthly gross profit runout carefully and conservatively – assume 10% less gross profit each month than forecast. This is a buffer as you have limited room for downside error!

- Adjust your indirect and direct overhead accordingly to create a profitable business model. Make whatever cuts are necessary
- Create an organizational plan to make up for any reduction in operations forces
- Include a productivity plan – possibly with incentives to achieve new profitability targets
- Maintain vendor payment flows within bounds to prevent a “death cycle” of joint checks, direct payments, and held invoices that can negatively impact cash flow
- Suspend any succession scenarios that require capital from the company to execute

3. Keep selling work, but don’t buy it. Taking work at insufficient margins increases your breakeven level and could lead to your demise. You must sell enough gross profit to stay ahead of your overhead costs
4. Borrow tactics from other quadrants where appropriate
5. If there is no viable strategy, consider winding the company down

CONCLUSION

The pandemic-fueled shutdown of large sectors of the world economy is unprecedented in most peoples’ working lifetimes. Effects on the construction industry are a major unknown at this point. It is prudent to make objective assessments of your company’s condition and follow the most appropriate strategies. This current disruption is certainly not a “one size fits all” situation.

Effective strategic planning is one of the major differentiators for long term success in the construction business. Look anew at your plans and make the appropriate adjustments (or even an entirely new plan if the situation demands it). Seek the best professional assistance to help you navigate the challenges of delivering construction services through the fog of an uncertain future.