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Prospering in Cyclical Markets

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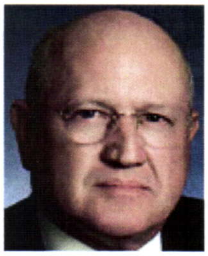
When a construction firm's backlog falls off, the pressure on the company escalates and "recession" takes on a new meaning regardless of the actual definition of the word. Prospering in cyclical markets and surviving a recession starts with recognizing what will happen when a market softens. The result is totally predictable and has occurred without fail in every industry down cycle for the last 50 years.



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When there are fewer projects, competition intensifies and prices and potential profits diminish. The ideal in a shrinking market would be for each contractor to accept proportionately less work so that market share of each business is maintained. But there is a tendency in our industry to resist any reduction and to fight vigorously for fewer available projects, driving down prices for everyone. Trying to maintain volume in a declining market is, in effect, an attempt to increase market share, and any increase in market share is universally "bought" at a cost.

Contractors resisting a reduction in their sales will load up on cheap work, which increases their risk. Conversely, cooperating with the market and downsizing to align your organization with market realities is appropriate risk management. Companies cannot control the market but can control their response to it.

The potential for profit measured as a percentage of sales is almost the same during a down market as it is in an up market, just more painful. A contractor's responsibility is to react to and manage risks in both cases. This includes taking difficult steps to downsize overhead. The largest by far of all overhead cost is salaries. While cutting nonessential costs such as subscriptions, bonuses, travel and entertainment, etc., is appropriate because it signals a new attitude to employees, it never amounts to enough to really matter. Reducing overhead requires a proportional reduction in management and administrative personnel.

Right-Sized

I regularly hear from contractors: "I can't operate with 10% or 20% less work. I have a 'drop-dead' volume I have to maintain to be viable." My response is, as you grew your business from $5 million and $10 million on your way to $15 million, were you profitable? Most contractors were.

The point is, if you have to go back to one of those reduced volumes, you need to size and configure the organization to exactly what it looked like when it was profitable at that size. This includes reducing equipment resources by selling, or if that is not practical, mothballing machines.

There is a tendency to hold onto people and equipment in order to be prepared when the market returns. But unless you expect a very short downturn, there is serious risk that resources will be retained at great expense only to be let go at a future date or that the drain on the organization may make it difficult or impossible to finance recovery when the market rebounds. The market always returns, but accurately predicting the length of a downturn is difficult, and the primary objective should be to profit.

Attracting, training and retaining good people has been a major issue for contractors during the recent boom, and serious resistance to these suggestions is understandable. However, timing is critical because there are real and significant costs to reacting late. One consolation is that there will be a glut of equipment and people during a downturn, and resources will be available if there is an early rebound.

Owners of construction enterprises must react to uncontrollable markets with processes that they can control. Unfortunately, the appropriate reactions range from difficult to distasteful. It is difficult but necessary to keep emotions out of business decisions, particularly because there is no minimizing the reality that someone has to look employees in the eye when they are laid off. Remember that managing risks to the organization protects the jobs of the larger number of employees that remain. Downsizing also provides an opportunity to weed out weaker employees and profit from a reduced volume of work by using an organization's best people. It is possible to prosper in this down cycle and maintain financial strength that will be critical when the rebound occurs.

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