

A Contractor's Survival Guide

BY KENTON FRIESEN

HEADS UP. THIS IS NOT the most ordinary of times in the construction industry. At the dawn of the 21st century, changes are afoot. Successful contractors aren't wasting time, shedding tears over the way things used to be. In this day and age, while victims of accelerated growth abound and equipment prices are skyrocketing, geographically-distant companies are suddenly competing in local markets. Consolidation is a reality that's feasting on mid-sized contracting companies and national and international standardization.

Canada's construction industry is healthier than could be expected considering the global economy, but that doesn't mean the trend of thinner profit margins has passed the maple leaf by. Builders and developers are forced to do more with less, placing a greater emphasis on solid research and business planning. Efficiency and high levels of productivity are no longer optional.

ILLUSTRATION BY ALINE GAUTHIER

Contractors are, by nature, a hearty lot - visionaries who often build companies single-handedly and enjoy the independence they've created. Attending to details like continual business research and strategizing rather than emulating the industry's historically exalted patterns of trial and error may not appear appetizing, but it leads to a future with greater predictability and less casualties. While contractors still need a good pickup truck, a cast iron stomach and a patient spouse, more and more a keen business sense is becoming the most valued tool in the box.

Surviving good times

Fair-weather casualties in the contracting business have historically littered the North American landscape, testament to the hard realities of extreme growth. Alberta's strong economy and effervescent construction industry is spiking the numbers for many, if not all contractors. Some have the managerial maturity to handle the large increases in business volume while others are self-destructing in an attempt to accomplish more than is feasible.

The risk of failure through over-aggressive growth is not a popular message among contractors, says Thomas C. Schleifer, author of *The Construction Contractors' Survival Guide*, who is often referred to as a turnaround artist because of the number of construction companies he has rescued from financial distress. "They say, 'The work's here. We're going to take it.' And the financial risk to them is huge," he explains. Schleifer discovered that business failures often occur as a result of events and decisions made during profitable years, usually one to three years before the first year of breaking even or loss.

In today's market, landing work is the easy part. The challenge is to make each job profitable. Premium pricing can be compromised as a firm pushes to expand market share while times are good. Bravado is often measured in annual business volume and the lure of landing more contracts can fly in the face of profitability.

Even if projects are performed profitably, increased volume creates cash flow strains. If growth comes in the form of bigger jobs, the high retention alone (the amount that is con-

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stantly unpaid) can signal disaster. A rule of thumb is to never take on a contract more than twice as big as the biggest one the company has handled to date. A continual increase in business volume demands a larger out-flow of cash than in-flow and requires "a lot more than a few extra bucks," says Schleifer. "Once you run out of financing, it's hard to recover. It just happens so rapidly."

If a closely-held contracting firm doubles its business volume in one year, it means half of its work is being performed by inexperienced people who had to be promoted or hired from outside. Crews that have been consistently profitable are broken up to facilitate the increase in simultaneous projects. Schleifer cautions that a highly expanded company is an untested entity until it can operate smoothly and profitably for at least one year.

Subtrades can also feel the brunt of increased business volume as they are expected to outperform normal volumes. It can lead to under-performance and inferior quality in spite of using trusted subcontractors.

Business collapse in good times is one of many factors indicating contractors seldom construct proper business plans, particularly in the start-up phase (which can last 10 years or more). Admittedly, it is most often passion and optimism that drives a construction company through its initial volatile years, but the lack of a solid business plan and the commitment to stick to it can allow that zeal to get out of hand. Many who fall prey to over expansion are good contractors, they are just not used to the sophistication creeping into the market that can require turning work away to survive.

According to Schleifer's extensive research data, annual growth of 15% or less is safe growth. The ratio of growth to failure goes almost straight line after that. Twenty-five to 50% is tough going and numbers in the neighbourhood of 100% are often devastating. "Obviously you can grow at 17, 18 or 20 (% annually), but it starts to get ugly after that."

If a contractor grows faster than 15%, that growth is best controlled by expanding in spurts. Cycles of growth and testing allow aggression tempered with evaluation - with the chance to back off from potentially fatal decisions.

Enduring equipment replacements

The failure to evaluate the real cost of equipment ownership is a growing problem, says Schleifer. "In tough times, (equipment intensive) enterprises begin to under price what they charge their equipment into the system, which gives them good profit and an advantage during the bidding. But when their equipment has to be replaced, they have no reserves so they find themselves going further and further into debt."

Modern equipment always costs more than the machinery being replaced, and, more often than not, it's an exaggerated difference. If contractors do not factor sufficient depreciation into each job and continually set aside reserves for it, the expense of replacement can be devastating. "If modern pieces come out, you have to buy them or your competitors are going to increase their production and you're not," says Schleifer.

Miscalculations on the equipment front can drag a superficially profitable year into the red. Today, almost any tool a contractor needs can be rented right from a drill up to a front-end loader. Numbers must be crunched to accurately decide the benefits of buying over renting or vice versa. If equipment is purchased, Schleifer suggests calculating the project costs in the same manner as if the equipment was leased.

Because almost any equipment can be rented almost anywhere, contractors can move into a distant town to do a small job without having to haul stacks of equipment. It's a far cry from 20 years ago when con-

struction was a local game and those with local knowledge, labour and connections had the competitive advantage. But taking jobs in distant locales is no longer the risk it used to be. "Nowadays big contractors are going anywhere they darn well please," says Schleifer. "They are very mobile."

A by-product of renting tools for projects outside a contractor's standard geographic area is the precise up-front calculation of equipment costs, further eliminating the chances of taking a loss.

Calculating on consolidation

There are staggering amounts of data being accumulated outlining consolidation of construction companies as a current trend. Schleifer says when the products of other service businesses such as grocery stores, gas stations and farms became commodities, consolidation was the next step. In every case, complete consolidation occurred within 25 years and the construction industry should

be no different. The consolidation curve began to head north in late 1997, suggesting a complete metamorphosis of the industry will occur by 2022 or earlier.

In his July 2000 construction forecast, Schleifer predicted the present period of consolidation will see the U.S. lose over 100,000 construction companies, most in the mid-size range. That's a loss of 20% of the construction entities south of the border. Research in the last few years confirms the prediction and Canada will not be excluded from the massive shift.

Driving the consolidation is a standardization of the industry. Current technology and simple information access is taking the mystery out of many aspects of the building process. Not long ago, adjusting to the diverse building codes from town to town was a dance of its own. Now, with the National Building Code of Canada 1995 and the Alberta Building Code 1997 (which is built on the national code), the code differentiations are

minute as are the differences from municipality to municipality.

The high risk in consolidation exists with mid-sized contractors. There will always be a market for smaller, niche contractors to capitalize on, says Schleifer, but mid-sized companies are already getting steamrolled by industry giants. "In the last couple of years, the market share for the very large contractors has jumped considerably."

And as corporate globalization continues, the demand for multi-national contractors will continue to rise, as big likes to deal with big. Also helping the expansion of the giants is the increasing frequency of multi-billion dollar construction projects, which exclude all but the biggest players. "In some areas [in the United States] where there's been significant growth in dollar value of construction, there has been no growth for anyone but the big guys," says Schleifer.

Up-sizing advantages are also evidenced by the profit margin decline in the construc-



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tion industry since the 1980s. Schleifer says the margins are structurally altered and will not rise to the heights considered the norm in previous decades, exacting higher productivity and efficiency standards to be profitable.

Mid-sized companies have to be prepared to either be bought out or face watching their main competition morph into a gorilla through being absorbed by a giant. The inherent independence of most contractors flies in the face of being bought out, yet it must be considered as consolidation is being fed by the short-sightedness of much of the industry. Detailed planning on how to capitalize from being bought out or how to survive if main competitors are bought out is a proactive approach that could stave off nasty surprises.

Unmuddling management

"Most of the good contractors know how to build the work. That's where their expertise is," says Schleifer. "It's not in planning. It's not in strategizing. Most of them have few long-term business plans, and those who do, from what I've observed, don't really follow them . . . They're looking after the next job, the next year. To most contractors, a long-term plan is two years when it needs to be five."

This applies particularly to small, closely-held companies that make up the largest percentage of the construction industry. In Schleifer's book, he writes, "After many years of working with distressed and failing contract businesses, I've determined that the causes (of failure) in 99% of the cases were management decisions alone."

Schleifer divides the running of a compa-

ny into three functional areas - estimating and sales (getting the work), construction operations (doing the work) and administration and accounting (managing the business). Typically, because most contracting firms are founded by one individual, all three functions are performed by the founder. Keeping the nose to the grindstone through landing and doing contracts often keeps business owners from the necessary tasks of administration and accounting.

Schleifer recommends that small company owners take time off the from the day-to-day duties at least three or four times annually to establish new goals, review and recommend policy and objectively measure management (often, personal) performance in reaching milestones. Establishing an active, independent board of directors to meet with during those evaluating periods is perhaps the best way to enforce objectivity, suggests Schleifer. Any successful member of the local business community is a valid choice, as long as trust and open communication can be expected. If implemented, those few hours per year spent with the board could dramatically and positively affect the future viability of a small firm.

If growth is the goal, proper management delegation is a necessity. And apprentices need to be given the opportunity to make real decisions that lead to real mistakes. With a proper management base in place, a company can move forward with maturity and profitability.

Forward, onward

There is more activity in the construction industry in Alberta now than there has been in the past two decades. There is energy. There is urgency. For contractors to extract the maximum benefit from current times takes solid business planning skills. If done right, the money being made now can help offset the inevitable downturn the industry will face sooner or later.

But without sound management that has the maturity to keep a finger on the pulse of the company, and that of the industry, the construction whirlwind can come and go with only scattered debris left to mark its passing. ☐

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