

HOW TO GROW YOUR CONSTRUCTION FIRM IN TODAY'S EXPANDING ECONOMY



It took awhile, but the economy finally seems to be on solid footing six years after the financial crisis and Great Recession. Construction activity, including new home construction, is booming again in many parts of the country.

Most contractors and construction firms rightly want to get in on the action. However, many realize the importance of not over-extending themselves in the ways that got them into trouble before the recession. The key is to embark on smart growth strategies that will position your firm to take advantage of new opportunities while limiting potential risk should another bust be lurking around the corner.

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► **Drastic Survival Actions**

Many contractors had to take some drastic actions in order to make it through the recession. These included cutting staff to the bare minimum while cross-training their remaining employees so they could take on the jobs of those who were let go. Of course, many contractors also had to cut their margins to the bone as well.

These survival strategies are fine during tough economic times, but they aren't very conducive to growing a contracting firm in an expanding economy. Taking advantage of today's growth opportunities requires smart thinking and strategic planning to avoid another round of "boom and bust" like we've witnessed so many times in the past. The goal should be to stabilize your workflow and resources so they are manageable during both busy and slow times.

This starts with staffing, which is one of the most challenging areas of a construction firm to manage. You should try to maintain as much flexibility as you can in staffing so it's easier to ramp employment up or down based on construction activity and your staff needs at any given time. Of course, you can hire subcontractors on an as-needed basis, but also try to build flexibility into your full-time office positions—for example, by using 1099 independent contractors instead of full-time employees when you can.

However, don't be penny-wise and pound-foolish when it comes to staffing. Hiring the right employees is critical to any successful contractor growth initiative. So is holding onto these employees—the construction industry is notorious for employees jumping from job to job for more pay or better benefits, so make sure your compensation package is competitive.

► **Cash Flow and Liquidity**

Cash flow is another critical area to watch as you plan your growth strategies, because nothing consumes cash like growth. When they land a large job, contractors often front-load the billing, so they're flush with cash early on. But this cash must be carefully managed throughout the course of the job so expenses and subcontractors can be paid later and you're not "robbing Peter to pay Paul." While it's always wise to have a line of credit you can tap if necessary, the reality is that general contractors should rarely if ever have to use it if they are managing their cash properly.

Keep in mind that while banks in general have begun to relax their lending standards since the depths of the recession, financing can still be an issue for contractors due to regulatory action that increases banks' risk ratings for High Volatility Commercial Real Estate (HVCRE) loans. Builders must now contribute upfront 15 percent of the appraised value of a completed project in cash equity and leave this in the project for the life of the loan. This represents the profit margin of many jobs, so the regulators are essentially requiring contractors to put their profit into a job and not get it out until the job is complete.

The most important financial key to success for contractors, however, is liquidity. History has shown that real estate always bounces back eventually, but contractors need to have enough liquidity to hold on until it does. In general, the contractors who survived the most recent recession and downturn and are now positioned for growth are the ones who made sure they had enough liquidity to carry them through the lean times.

Keeping fixed costs down is a key to maintaining strong cash flow and liquidity regardless of business conditions and activity. For example, do you really need to buy that expensive piece of equipment that is only going to be used on one job? Renting or leasing it might

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make more sense. Also, it's not uncommon for contractors and construction firm owners to live "high on the hog" during boom times — buying luxury homes, vehicles, watercraft and private airplanes. These are the kinds of expenses, however, that can drag a firm down when cash gets tight.

► **Find Your Firm's Sweet Spot**

Before and during the recession, some contractors broadened their focus in order to bid on jobs that were outside their normal areas of expertise. For example, some builders of mid-priced tract homes moved up into higher-priced luxury homes — however, many didn't have the necessary expertise or access to subcontractors who could deliver the level of quality required at these price points. They also had to tie up a lot more capital in these homes than they were used to, which often led to cash flow and liquidity problems. As you plan your growth strategy, it's a good idea to figure out in which markets you can be the most competitive and profitable and then stay focused in these areas. Build your staff and hire your subcontractors with these markets in mind — and don't give in to the temptation to chase jobs outside of your sweet spots if you're not sure you can do the work efficiently and earn a healthy profit. Also make sure you understand the contract and bonding requirements of any job before making a bid.

Finally, be sure you know why you want to grow your contracting firm. Some contractors want to grow just for growth's sake, even if growth isn't in their best interest right now. Taking on a big contract or a job outside of your sweet spot that you aren't prepared for can cause long-term damage to your construction business.

► **Formulate a Strategic Growth Plan**

With the economy on relatively solid footing and both commercial and residential construction on the rebound in much of the country, now is the time to plan the future direction for your contracting firm.

Without a plan, you'll be tempted to chase after whatever jobs might look attractive on the surface. A strategic growth plan will help you focus your attention and resources in the areas that promise the highest potential return for your construction firm.

Construction activity is booming again in many parts of the country, and most contractors and construction firms rightly want to get it on the action. However, many realize the importance of not over-extending themselves in the ways that got them into trouble before the recession. The key is to embark on smart growth strategies that will position your firm to take advantage of new opportunities while limiting potential risk should another bust be lurking around the corner.

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