

## **Workshop W4**

**Wednesday, November 4, 9:00 a.m.–noon**

### **SURVIVAL STRATEGIES FOR CONTRACTORS**

**Presented by**

**John S. Alberici**  
**President (Alberici Group),**  
**Chairman (Alberici Corp.)**

Even in good times, most contractors and subcontractors operate on thin margins, and in bad times these margins get even thinner. As contractors begin to reach the end of their backlog, and new projects are harder to come by, management must be preparing a plan to stay afloat until the economy recovers. This workshop first outlines some key issues contractors must address to avoid the fate of so many others who have already closed their doors. One of the key challenges contractors will face is maintaining access to surety credit. Learn strategies for winding down current projects while gearing up to success going forward, including strategies for maintaining a balance sheet that sureties will be willing to stand behind.



# Putting The Pieces Of Building and Business Together

When it comes to creating new contacts and connections, we create the perfect fit. From enhancing market relationships and creating alternative risk financing to forming joint ventures and acquisition opportunities, our team of experts can put it all together for you.

*For more information, contact  
Aon Construction Services Group  
888.678.7310 or [aon.com](http://aon.com)*

**AON**  
*Construction Services Group  
Beyond Protection. Partnership.*

**John S. Alberici**  
**President, Alberici Group**  
**Chairman, Alberici Corporation**

Mr. Alberici is one of the presenters for Workshop W4, "Survival Strategies for Contractors," on Wednesday morning. He is chairman of Alberici Corporation. He is president of Alberici Group, parent company of the 47th largest construction entity in the U.S. His direct management oversight includes Finance, Risk Management, Information Technology, Human Resources and Legal Services. He is also president of two insurance subsidiaries of the corporation.

Mr. Alberici is past chair of the Associated General Contractors (AGC) of St. Louis. He is a longtime member and past chair of the Risk Management and the Surety committees of the AGC of America. He has been a member of the Board of Trustees of Saint Louis University and over the span of 25 years chaired their Building and Grounds and the Human Resources committees.

Mr. Alberici is a past chair of the Vermont Captive Insurance Association and is a frequent speaker at insurance and construction venues. He is also a spokesman for sustainable (green) construction. His corporate headquarters has received numerous environmental awards including the USGBC's LEED Platinum designation in 2005.

## **Notes**

This file is set up for duplexed printing. Therefore, there are pages that are intentionally left blank. If you print this file, we suggest that you set your printer to duplex.

# **SURVIVAL STRATEGIES FOR CONTRACTORS**

---

*John S. Alberici*

*“Inaction is the riskiest response to the uncertainties of an economic crisis. But rash or scattershot action can be nearly as damaging. Rising anxiety (how much worse are things likely to get? how long is this going to last?) and the growing pressure to do something often produces a variety of uncoordinated moves that target the wrong problem or overshoot the right one. A disorganized response can also generate a sense of panic in an organization. And that will distract people from seeing something crucially important: the hidden but significant opportunities among the bad economic news.”*

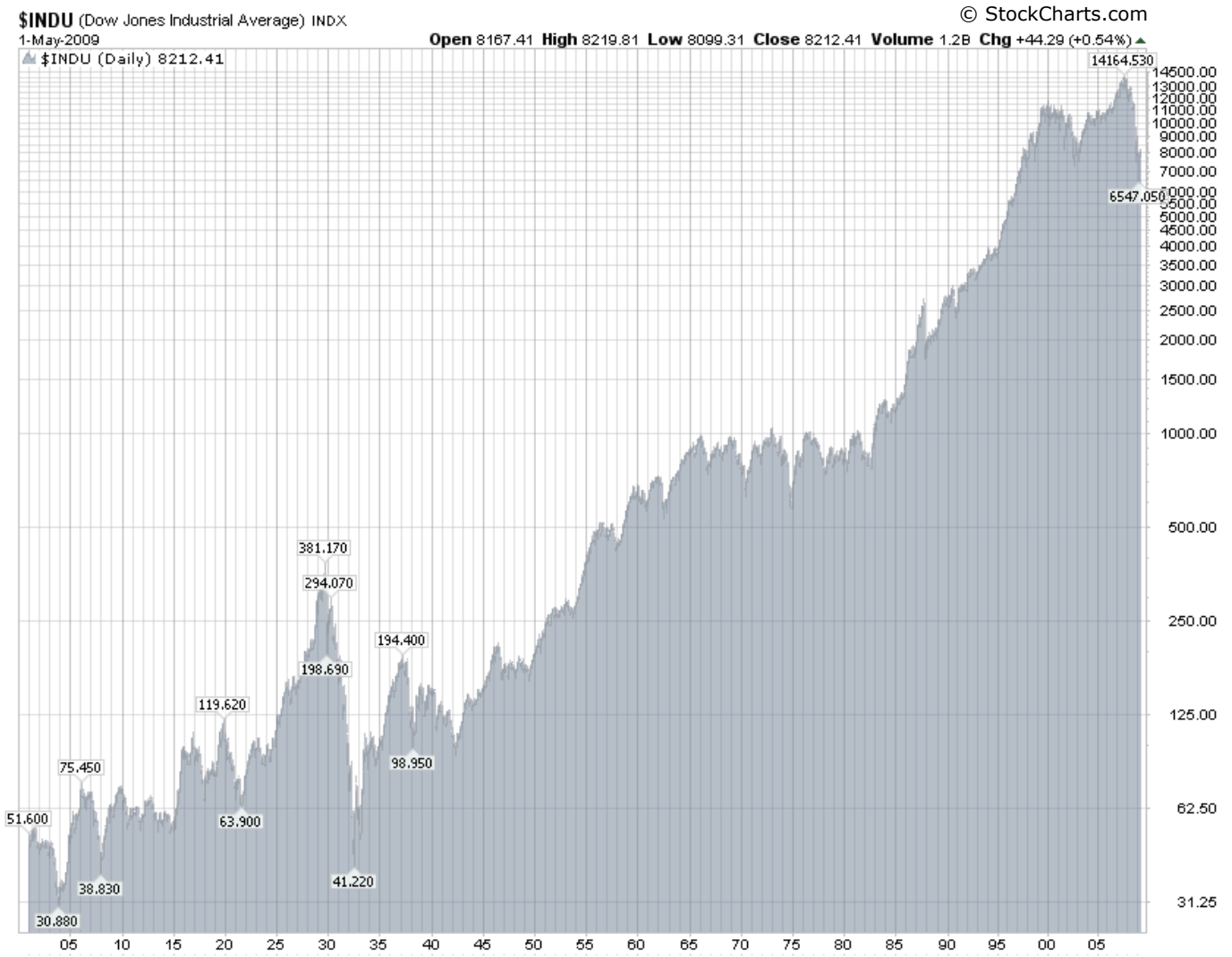
- David Rhodes and Daniel Stelter, “Seizing Advantage in a Downturn.” *Harvard Business Review*, February 2009

## Surviving Difficult Economic Times is all about context and strategy

- Economic Perspective:
  - The current turbulent economy is by no means unprecedented. However, if you entered the workforce since 1980, you probably have no firsthand experience dealing with it.
  - The early '80s ushered in a 25-year economic expansion marked by exceptional wealth creation, political stability, and only minor recessionary periods.
    - In 1982 the combined net worth of U.S. households equaled \$11 trillion. Today it exceeds \$56 trillion.
    - Since 1982, the U.S. economy added a net increase of 40 million new jobs, more than the rest of the industrial world combined.
  - Toward the end of 2007, the expansion ended in a worldwide credit crisis and market downturn with uncertain long-term consequences.
    - Banking losses eclipsed previous financial disasters such as the U.S. savings and loan crisis (1986-1995) or the Japanese banking crisis (1990-1999).
    - Consumer and corporate indebtedness in the United States in 2007 amounted to 380 percent of GDP, nearly 2.5 times the level at the beginning of the great depression.
  - What does that bode for the future?
    - During the recent 25-year expansion the U.S. economy proved resilient. With government intervention and stimulation, won't the economy recover quickly?
      - Perhaps, but ...

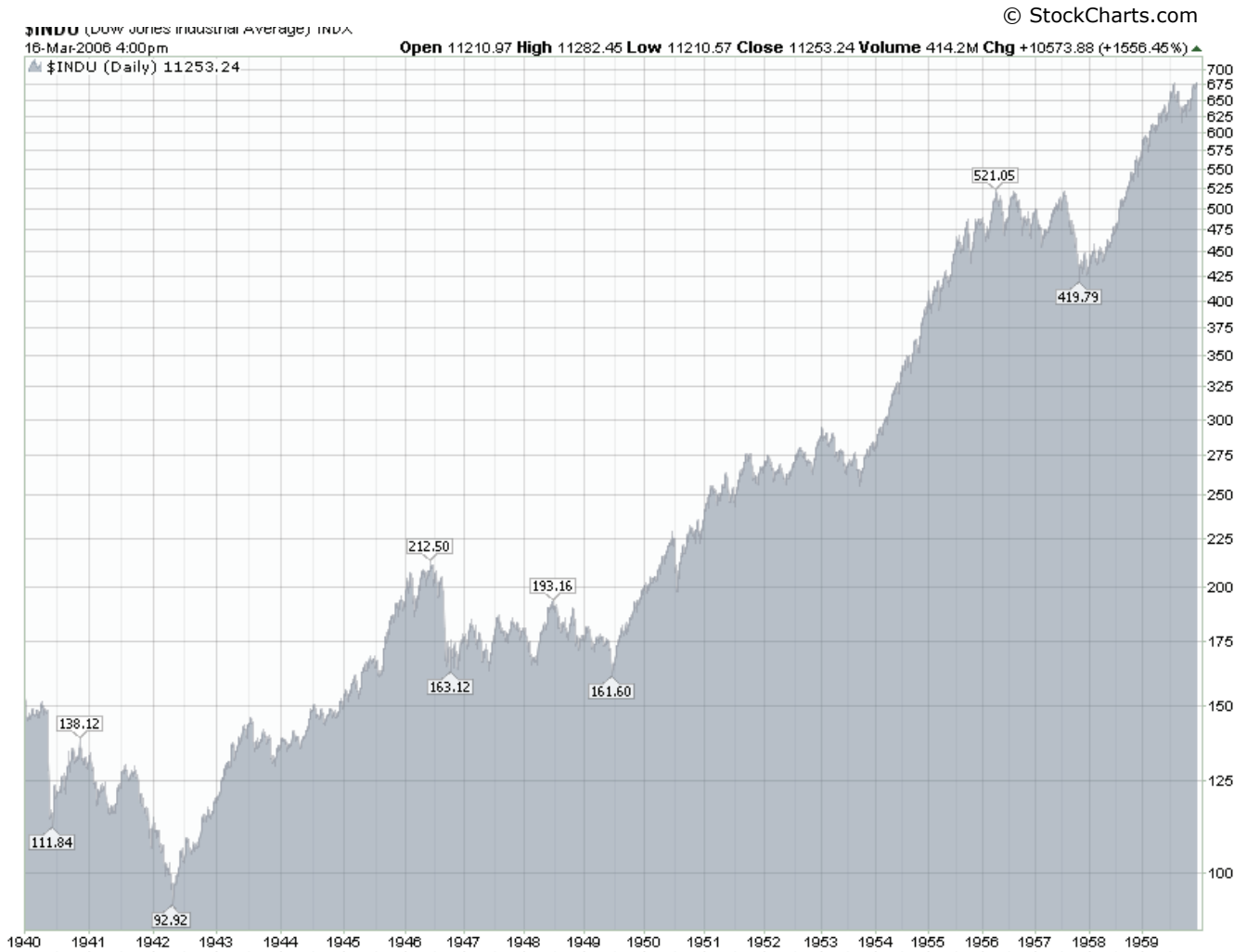
Past performance is not an indicator of future outcome ... or is it?

- Take for example the following graphs of the Dow Jones Industrial Average since 1900:

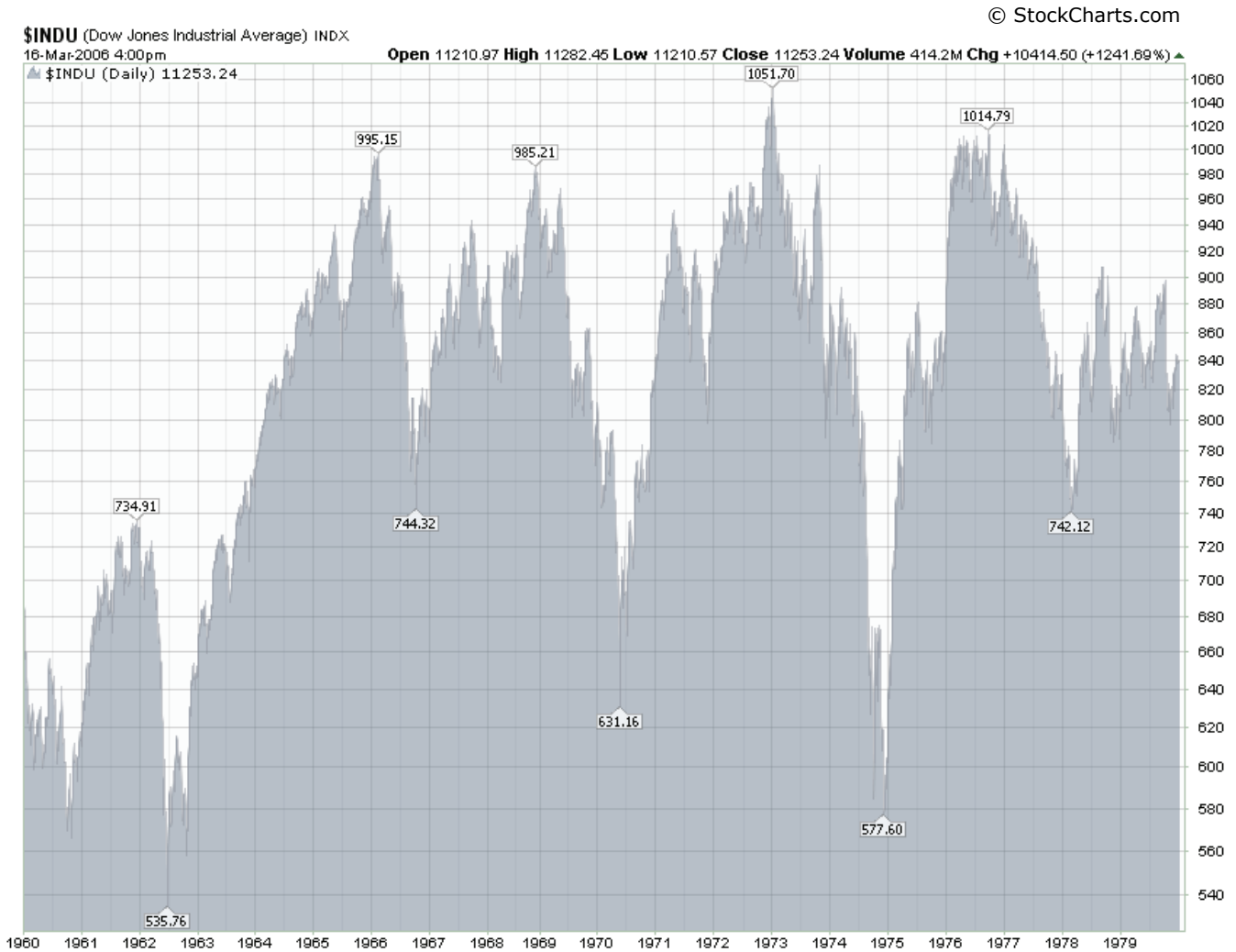


Workshop W4

- There was a somewhat similar uninterrupted quarter-century growth period from 1942-1966:



- After that, the market and the economy plateau-ed with no sustained growth for the next 16 years.



Workshop W4

- To determine possible impacts the economy will have on your company, you must perform an economic analysis, which should include a variety of possible scenarios:
  - Modest economic downturn
  - Severe recession
  - Depression
 ... defined by both duration and severity.

- The effects can be local, regional, national, or global.
- Downturns or economic stagnation may be protracted.
- This high-level economic analysis is critical and leads to many objective and subjective questions that you and your company must answer, such as:
  - How will the economic conditions affect your company and your competitors in the near, mid, and long term?
  - Are your markets and geographic areas uniformly down?
  - Are some segments steady or even growing?
  - What strategy and tactics will help insure your ultimate success?
- The last question is really the segue from overarching economic conditions that you cannot control to an actionable strategy that is much more within your control.
- To help frame this analysis, here are the following areas of examination:
  - Financials
  - Personnel
  - Risk management
  - Strategic approach to operations
- Your response may be somewhat different, depending on your specific circumstances. This is merely an outline from which to begin.

## **Financials**

- Careful monitoring of key financial indicators is always important, but it plays an even more significant role in an economic downturn.
- To start, let's stratify financials into the top-line and bottom-line issues.

- Top:
  - The top line is critical because it generates cash that you need to meet current obligations. In a seized credit market, an interruption of cash can be fatal.
    - Develop a timeline of anticipated cash inflows and outflows
    - Develop a weekly or monthly cash report
    - If you have multiple units, centralize cash management
    - Where possible, accelerate receivables and defer payables
    - Analyze if some segments of your business are cash generators or cash hogs for later decision-making
    - Stay attuned to competitor responses to protect your core business and core client base
    - Adjust elements of business development and estimating to reflect the changing market conditions
- Bottom:
  - Lowering your margins to increase short-term revenue may be necessary in emergency circumstances, but it removes any cushion against potential project losses and drains capital the company may need to weather a long downturn and reposition itself for success.
  - An alternative is to streamline the organization by reducing costs and increasing efficiency.
    - Enlist employee suggestions for cost cutting
    - Cease activities that add little business value
    - Review suppliers and procurement practices
    - Establish stringent capital allocation guidelines
    - Implement efficiency initiatives that might have been unpopular in better times
    - Eliminate redundant functions and reduce organizational hierarchy
- If you can't control your finances, you can't control your destiny

## Personnel

- Personnel costs (direct pay, bonuses, benefits, and retirement distributions, etc.) can make up two-thirds of corporate overhead. No other area offers as much opportunity for budget balancing. Simultaneously, it is the most difficult to get right, touching as it does every element of the business from project performance to corporate culture.
- If the economic downturn promises to be brief and shallow, personnel actions may be more measured and include:
  - Elimination of bonuses
  - Pay freezes or cuts
  - Reduction of benefits or increased cost sharing
  - Unpaid vacations or days off
  - Inducements for voluntary separations
- These steps may ultimately be more cost-effective because you avoid the expense of recruiting, hiring, and training new people who will be needed when the economy recovers.
- If the downturn is more severe or the company's financial situation is stressed, layoffs may be necessary.
  - Some may see a silver lining
    - Overdue trimming of bloated departments
    - Purging of non-essential or ill-fitting personnel
    - Opportunity for more qualified individuals to step into new responsibilities
  - In any case, a layoff plan should be seen as fair and reasonable (considering the economic conditions) and necessary to ensure the survival of the company as a whole

- A layoff plan can take a variety of forms, each with pluses and minuses:

Method	Pluses	Minuses
<p>FIFO (First in first out)</p> <p>Highest tenure dismissed</p>	<p>Eliminates employees who may not be able to keep up with newer processes or technologies or who may have gotten complacent</p> <p>Typically higher-compensated group, so fewer personnel losses will have a higher impact on overhead</p>	<p>Loss of greatest store of institutional knowledge, industry connections, client association, and project experience</p> <p>Most likely to open the company to charges of age discrimination</p>
<p>LIFO (Last in first out)</p> <p>Lowest tenure dismissed</p>	<p>Cutting employees with least experience and company connections causes the lowest impact on company culture, morale, and client contact</p> <p>Less severance involved and typically younger workers will have easier time changing careers</p>	<p>Loss of most energetic, tech-savvy people who may become the company's future stars</p> <p>Typically lower compensated group, so need higher headcount losses to have the same impact on overhead</p> <p>Recruiting new talent may be more difficult if company gets reputation for severing new hires</p>
<p>Gradation</p> <p>Give each employee a grade and eliminate lowest</p>	<p>Sets high standards for achievement, keeps employees goal-oriented, helps develop a higher-performing workforce overall</p> <p>Forces supervisors to assess strengths and weaknesses of direct reports and correct deficiencies on an ongoing basis</p>	<p>Low achievement employees may not be evenly distributed across all departments/divisions to mirror where cuts need to take place</p> <p>Most companies do evaluations badly. Some managers may be tough, others lenient, and some may be swayed by biases</p> <p>May lead to harsh office politics</p>
<p>Decimation</p> <p>Each department/division cuts a percentage of people or employment costs</p>	<p>Achieves the exact amount of overhead reduction needed</p> <p>Allows departments flexibility in how to meet goals</p> <p>Easy to explain and takes the least time to develop</p> <p>Burden of loss falls evenly across all functions, which may be seen as inherently fair</p>	<p>This has the least connection to strategy since some units may be more critical to the ultimate survival of the company</p> <p>The already efficient and most leanly staffed departments will suffer the most</p> <p>Doesn't take team workload or timing into consideration</p>
<p>Amputation</p> <p>Eliminate a whole department or business unit</p>	<p>Adheres to strategy by eliminating unproductive units that may not fit in the changing economy</p> <p>Keeps units with the best fit intact</p> <p>Management may find they can outsource department functions more efficiently at a lower cost and focus instead on core competencies</p>	<p>You may lose "A" players within severed units that your competition would be glad to hire individually</p> <p>If management guesses wrong about strategic direction or if outsourcing proves disastrous, there is no framework on which to rebuild</p>

- No matter what you do with personnel, you need to have a good communications strategy in place.
  - When possible, inform employees that changes are planned so that they have time to absorb and understand the reasons.
  - Communication should come from the highest levels and be reinforced by the line managers to their individual departments.
  - Keep communication two-way. Involve employees in the quest to reduce overhead by asking for their ideas and input on process improvement and cost-cutting measures.
  - Be honest about communicating the situation. If you do not know how something is going to turn out, say so. Set appropriate expectations in order to maintain credibility (no guarantees).
  
- Other important layoff considerations:
  - If timing allows, cutbacks should be done at once. A series of small changes will leave employees wondering what is coming next and will chip away at morale.
  - Provide working notice when appropriate.
  - Have a structured severance program to maintain equity and limit exposure.
  - Consider the importance of transition services, which will be appreciated by separated and current employees.
  - Remember that management will be judged in the handling of layoffs by all employees who remain. You need to get their buy-in because in order to do more with less, the company will need its top talent to perform its best.
  - Do what it takes to reduce collateral damage. Your “A” players are always in demand, no matter the economic situation. For your best performers, consider non-financial rewards such as professional development, training, mentoring, and career advancement.

## Risk Management

- You have some control over the factors influencing your company (by making good predictions based on your financial situation) and your strategy for coping with the downturn (operating costs), but there are many factors that you cannot control, including owners, subcontractors, or other external entities (competitors, government organizations, etc.)
- Manage risk both upstream (owners) and down (subcontractors)
  - Approach to owners:
    - Segment your customers by assigning each a credit rating. Stay current on their financial conditions or their potential for bankruptcy.
    - Avoid onerous contract terms and conditions, especially from higher-risk customers or those whose business is less strategically important to you.
    - Make sure payment terms are acceptable and monitor receivables closely.
    - Review ongoing contracts. Provide appropriate notice and documentation if you need to stop work for non-payment by an owner.
    - Minimize your exposure (material, equipment, personnel) to project cancellations. Do scenario planning and be aware ... delays may be more insidious than cancellations. Even clients with the best intentions are subject to factors beyond their control.
  - Approach to subcontractors:
    - As with owners, monitor the financial conditions of subcontractors through business networks, credit bureau reports, media, and trade sources
      - Are they paying their suppliers and sub tiers?
      - Are they getting paid by other general contractors?
      - Do they have federal tax liens?
      - Are they current with union contributions?
      - Has their bonding status changed?

- Other signs of financial stress
  - Personnel losses reflected in project staffing
  - Significantly lower bids to competitors in the marketplace
  - Changes in attitude, adherence to safety practices, work progress, or ethical standards
- Insurance considerations
  - Watch for fraudulent insurance certificates
  - Reduction of limits
  - Cancellation of policies
- Bottom line: take an appropriate amount of risk for your strategy. Remember: You can go out of business a lot faster with bad projects than you can with no projects.

### **Strategic approach to operations**

- There are many facets and approaches to developing strategy, informed by your analysis of the economic situation. Knowing all of that, it is probably a good time to circle back and ask some basic questions.
  - Does your company realistically have the resources to survive the downturn?
  - Should you consider a merger or divestiture to keep operations intact?
  - Will the business landscape change so significantly to cause a major shift in your business plan?
  - Should the opportunity or need for major acquisition be considered?
  - If you are a family company, how will these changes affect family members?
  - Do you personally have the energy and desire to manage through a recession?
    - Remember, it can be protracted, and even if the general economy picks up, it can be very spotty by industry or region, and construction may lag behind the general recovery by a year or more.
- While speed is helpful, to counter growing anxiety in an organization, it is unproductive to lurch into action without a coordinated plan.

- The context and situational analysis will help you communicate the justification and motivation for actions needed in response to an economic crisis.
  - It restores confidence that, even under stress, the company is on the right track.
  - A well-reasoned strategy gets people focused on a confident future instead of being mired in the uncertainties of the present.
  - It provides a filter for when strategic hires present themselves, either someone particularly good at what you already do, or someone with expertise in a new area that fits your strategy.
- An additional word of caution: While you're working on your route to survival, don't abandon what you've done to get where you are.
  - In other words, maintain your standards. Any drop in safety, quality, social responsibility, or ethics may irreparably harm your chances for recovery.
- As difficult as restructuring and downsizing may be, it ultimately will allow the company to be more efficient and competitive when the economy improves.
- Be open to change.

***It is not the strongest of the species that survives, nor the most intelligent, but the one most responsive to change.***

- Charles Darwin

## **Notes**

This file is set up for duplexed printing. Therefore, there are pages that are intentionally left blank. If you print this file, we suggest that you set your printer to duplex.