

Sage Construction and Real Estate

No U-Turns Allowed

9 Tips to Help Contractors Survive Recessions
and Build Stronger Businesses



Introduction

Contractors face a slew of challenges this year. The global recession that started with the downturn in U.S. residential housing continues. Gloomy headlines, slowing sales, and rising unemployment have combined to create a high level of pessimism in the construction industry.¹

There's no question that it's tough out there. Housing starts and total construction spending have decreased year-over-year.² And there is a large inventory of unsold homes that need to clear the marketplace before significant recovery can occur.

There are some compelling reasons to believe the economy might begin to turn the corner later this year. The government is responding to this recession with unprecedented spending on economic stimulus. But contractors will have to weather tough conditions for at least a few more months before the government stimulus can begin to make a positive impact in the economy.

Are we there yet?

David Crowe, chief economist for the National Association of Home Builders, believes a slow recovery will begin this year. "I do think we will see a bottom in 2009 and by the end of this year we will start to see the beginning of a recovery. But it will be a slow recovery because of the significant overhang of empty houses for sale," he acknowledged in a recent interview.³

The current stimulus package includes funding for shovel-ready public construction projects that will provide contractors with work for their crews and a guaranteed payday. Meanwhile, interest rates are very low and new tax credits for first-time home buyers should increase demand. Other government programs will focus on shoring up banking institutions and should lead to more lending activity. Healthier banks will be able to maintain and protect your business lines of credit, and finance projects for your customers.

Anirban Basu, chief economist for Associated Builders and Contractors, Inc., sees some areas of opportunity in commercial construction, although he anticipates the overall economic picture to remain bleak through 2009. "The ongoing U.S. recession has become increasingly apparent in the level of nonresidential construction activities," he wrote recently in the Construction Economic Update, "Fortunately, there are several positive elements in the economic environment, including the infrastructure component of the stimulus package, ongoing military-related construction in many parts of the United States and falling construction input prices."⁴

¹ Wells Fargo Construction Industry Forecast 2009

² Associated Builders and Contractors, Inc., Construction Economic Update, February 6 and February 2, 2009

³ Martine Crutsinger, "Home construction drops far more than expected," Associated Press, February 18, 2009

⁴ Associated Builders and Contractors, Inc., "Private Nonresidential Construction Spending Drops Further in January," Construction Economic Update, March 2, 2009.

Find the fast lane to recovery

Contractors who employ smart strategies today can enjoy increased profitability and market share when the economy turns around. Financially healthy construction businesses build competitive advantage during recessions by taking advantage of:

- Falling materials prices
- Reduced competition as less able businesses fail
- Fire sale prices on equipment
- Opportunity to purchase competitors' businesses
- Ability to hire the best talent

Right now, your company needs to survive so that it can thrive later. This guide contains nine tips to help you run a smart business in a rough economy and position your company to gain competitive advantage in the next economic expansion.

TIP #1: Cash IS King

When business is hot and jobs are plentiful, it's critical to set aside cash for slower times. This is especially true in industries prone to booms and busts, such as construction and real estate. The cash you saved during good years will provide a cushion to see your business through the recession.

How do you know if you have enough cash? Experts typically recommend having enough cash and established lines of credit to fund your business for one year. Of course, the bigger your cash reserve, the longer you can survive if the downturn persists.

Since this economic contraction has already gone deeper than predicted, it is more important than ever to watch, understand and plan your cash flow. You should review a daily, or at a minimum, weekly cash flow report and check it carefully before approving any expenses.

Cash flow and cash preservation should be your top priority. Do a thorough review of your operational and financial information to find ways to cut unnecessary expenses and maximize efficiency.

TIP #2: Plan by the Numbers

If you haven't developed a contingency plan for economic downturns, there's no time to lose. According to Jayme Broudy, founder of the Contractor's Business School, the key to surviving recessions is to be the most efficient, well-managed business in your area. And the way to do that is to live by a well-constructed contingency plan.¹

Many businesses can improve the bottom line by up to 5% just by gathering and analyzing information more effectively. To improve cash flow and guard your reserves, you need to know your business inside and out so that you can cut in the right places. When you're in the midst of a crisis, you won't have time to do that kind of analysis. A contingency plan helps you make the best decisions quickly.

¹ Jayme Dill Broudy, "Contingency Plan Key to Surviving Economic Downturns," Construction Equipment Guide.com, December 15, 2007.

Your plan should include what you will do about manpower, equipment, pricing, overhead, cash and expenses at differing levels of revenue and economic conditions. For example, if business drops off 20%, where will you make cuts? Do you need to lay off employees? Will you sell equipment, or rent it out? If revenue drops an additional 10% next quarter, what further actions will you take? Your contingency plan should answer these questions based on quantifiable past performance data.

Use your accounting software to generate reports that help you model what-if scenarios. Review past quarter and past year total labor costs, equipment costs, and materials costs. You should be able to see trends in these costs—are they going up or down? Use job cost reporting to analyze the average profitability of your jobs and know what types of projects are most profitable for your business. Go over your P&L carefully on a regular basis. If you can't produce these reports quickly and easily, it's time to upgrade or replace your current accounting software.

TIP #3: Protect Profit Margins

With fewer projects available, you'll want to bid on—and win—as many projects as you can. But you don't want to underbid and suffer a costly mistake. It's more important than ever to produce fast, accurate estimates. Material costs have changed rapidly over the past two years, first shooting through the roof and now falling back. It's impossible to keep an accurate spreadsheet of all your estimating cost.

Consider using estimating software that includes a specialized database with regular updates to ensure that you are using accurate costs for your materials and labor. Automated estimating software can help you complete each estimate in as little as half the time of manual calculations, so you can compete for twice as many jobs. An estimating solution that integrates with your accounting and operations software significantly increases efficiencies and reduces errors.

If your payroll expenses are too high, do not wait to make necessary reductions in force. Payroll and benefits represent the largest expense in most businesses. Use your contingency plan and try to identify and cut the least productive (and therefore least profitable) employees first. The longer you wait to cut costs, the more cash you will burn. If you keep your business healthy, you'll be able to create new jobs when recovery begins.

TIP #4: Trust but Verify

With credit harder to come by, it's not just about getting jobs anymore. It's about getting paid. Protect yourself with airtight contracts and careful verification of prospective customers. Pre-qualify customers to make sure they are able to pay before work commences.

Bankruptcies are increasing, so keep a watchful eye on your accounts receivable. When payment is due, follow-up promptly, and preserve your company's lien and bond rights until you have been paid in full. You don't want to find yourself at the back of the line if your customer goes into bankruptcy.

You'll also need to verify that your subcontractors are sufficiently solvent to finish the jobs that you hire them to do. And unless your state allows "pay if paid" contracts, you will owe your subcontractors for work completed even if your customer fails to pay.¹

¹ Lee A. Weintraub, "Practical Steps to Help GCs Weather Economic Hard Times," CFMA Building Profits, November 2008.

TIP #5: Don't Stop Marketing

Experienced business owners know that if you advertise when others are silent, more prospective customers will hear you! Companies that preserve their marketing budgets will benefit from the reduced noise in the marketplace.

What types of marketing should you invest in? First, make it easy for prospective customers to find your company. Build and maintain a website, advertise in the phone book, and learn about how to improve your company's ranking in online search engines (or hire a consultant).

Don't forget about low-cost or no-cost advertising. Can you place flyers in a local home improvement store, or other high traffic location? How about online advertising on basic, yet popular, sites like Craig's List?

TIP #6: Give Exceptional Customer Service

You probably know first-hand that word of mouth referrals are the best kind of advertising. Deals close more easily when an existing customer vouches for the quality of your work. Word of mouth advertising is one of your most valuable resources—and it costs you nothing but great customer service.

Make sure that your existing customers continue to be satisfied with your work. If something goes wrong, make every effort to fix it right away. An angry customer can do more damage to your reputation than a satisfied customer can enhance it. A study conducted in Texas revealed that the average dissatisfied customer gripes to 11 people about his experience, and these 11 each tell five more people.¹ That's 66 or more people in your community with a preconceived negative opinion about your company! That's how critical excellent customer service is to your business.

TIP #7: Redirect Existing Skills to New Areas

During boom times, it pays to specialize. Having a niche allows you to concentrate all of your efforts on one type of project so that you can do more of them in less time. In a downturn, the opposite may be true. So, don't let old habits prevent you from applying your experience and skills to other types of construction projects. Consider trying to:

- Renovate, remodel and rehab – If you've been building new construction, you have the right skills and equipment to improve on existing construction too.
- Expand your territory – Look to neighboring geographic areas for potential new business.
- With some competitors calling it quits, and gas prices much lower than last year, it may pay to drive a little farther.
- Bid on public projects – If you'd like to try for some of the shovel-ready public projects promised in the stimulus bill, be sure your accounting and payroll software supports multiple pay rates. You'll need to comply with "Prevailing Wage" laws for federal and some state funded contracts.

¹ Ivan Misner, "Watch Your Word-of-Mouth," Entrepreneur, July 26, 2007.

TIP #8: Improve Your Documentation

It's a fact—when the economy deteriorates, more lawsuits get filed. Because your company is more likely to be involved in litigation, it's critically important that you keep proper records and documentation to support the work that you perform. Whether you are forced to sue a defaulting client, or your company is named as the defendant, your attorney is more likely to prevail when you have complete documentation.

Make sure you have an organized system to keep estimates, contracts, notices to proceed, change orders, and other key documents for every project. Ideally, you should be able to store this documentation electronically so that it is easy to find and distribute if your attorney needs it. Sometimes, you may even be able to avoid the courtroom altogether with proactive documentation and that will save you a lot of expense and frustration.

TIP #9: Re-invest Profits

If you've built an adequate cash reserve, this downturn could be a smart time to invest strategically in your business. While your competitors are hunkering down, you can take advantage of opportunities to improve your business and become more productive.

Your investment in tools, trucks, and other heavy equipment will go further today than it would have in the recent boom years. You can also take advantage of this time to upgrade your business management software in ways that will help you win more jobs. Consider construction-specific accounting software, as well as project management and estimating solutions.

Whatever capital expenditures you plan, you are likely to find excellent prices that would have had contractors lining up two years ago! When the next economic expansion comes, you'll have what you need to make the most of it, at a fraction of what your competitors will have to pay.

If you purchase equipment, vehicles, or software for your business in 2009, you can take advantage of tax incentives included in the new stimulus bill. Higher Section 179 limits allow you to fully expense up to \$250,000 of depreciable business equipment, including software, during the 2009 tax year. Or, you can enjoy 50% bonus depreciation on eligible assets. Consult your accountant or tax advisor for details.

Finally, don't forget to invest in your people. A less busy schedule creates the perfect opportunity to participate in advanced training and learn new skills. By expanding your knowledge, you'll find new opportunities for your business and discover ways to serve existing customers better.

In Conclusion

With good planning and some strategic thinking, your company can come out of this recession stronger and more competitive than ever. If you guard your cash flow, stick to your contingency plan, look for different types of projects, and keep investing in your business, you will be ready for new opportunities.

Based on the average length of previous recessions, the economy is likely to begin improving in 2009. Use this time to boost productivity, become more efficient, and engage in effective cost-cutting. Your company will be leaner and healthier than competitors when the economy turns around.

Drive Your Business Forward with Sage!

For over 30 years, contractors have depended on Sage 300 Construction and Real Estate (formerly Sage Timberline Office) and Sage 100 Contractor (formerly Sage Master Builder) for construction-specific software that improves productivity and profitability. Sage provides award-winning software and support to more than 21,000 construction and real estate customers in the U.S. and Canada.

Take your company to the next level when you manage and connect all aspects of your business with integrated software solutions for accounting, estimating, project management, procurement, and more.

To learn more about how Sage solutions can support your business objectives and help you implement the strategies in this guide, visit www.sagecre.com or call **800-628-6583**.

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