Good morning, everybody, Dennis Engelbrecht, Digging Deeper.

Today, I wanted to alert you to something that's going on. As this oftentimes comes on kind of slowly, wanted to make sure that as leaders you're paying the proper attention to rising risk. All right? Rising risk. What makes me think risk is rising in the construction industry? Well, a couple of things. First of all, we're in a high inflation era. The inputs to construction have grown 50% within a year. The price of a construction project is largely up about 20 plus percent to produce the same project as it cost as little as two years ago. What's bad or risky about that? Well, it's higher dollars, very simple. This can possibly go unnoticed, especially if you're operating with a similar equity to what you used to have. By having this inflation, have more dollar risk at play.

You're probably going to do the largest project you've ever done in terms of dollars this year. Again, that's not necessarily because the project's bigger or more complex, it's simply that the dollars are bigger. Again, this is something that's maybe creeping up on you, but there's increased risk there just because the dollars are higher. Think about it this way. If a supplier fails on you, or a subcontractor fails on you, the cost of replacing that is going to be higher and higher in this inflationary era. Therefore, just simply greater risk. The other thing that's going on with this inflation, and also supply chain disruption, is somebody does have to pay for that. It is to a certain extent a game of musical chairs. These problems are going to arise, they are arising. Who's going to take financial responsibility for those problems, is ultimately the game of musical chairs.

You don't want to be the one holding the bag when the music stops, to not be able to find your chair. Now, I think most of us in the construction industry would like to say, "Well, that's an owner's problem," but unfortunately, because of the way we bid things and price things. And then sign contracts about them, these disruptions occur, and somebody has to take the hit for them. That's not just in money, but also schedule, attainment, time. A lot of risk in that area. Another risk you probably haven't thought of, but because of the tightening, and tightening workplace dynamics, and the sort of change in mindset among your employees, probably the risk of losing one of your key employees is probably higher than it's ever been. This could be the key employee that, superintendent, project manager, project director. Or pre con professional, that you were counting on to do this particular job. Or this largest job you've ever done or something like that.

That risk is also out there. Again, with the number of people changing jobs, quits at its highest rate ever in the history of construction, that risk is simply out there, no matter how well you think your culture is doing. And how good you think you're doing with your people, that risk is simply increasing. The next risk I want to talk about is the risk of disappearing backlog. What do I mean by that? Well, we're moving into a higher interest rate environment. We have the risk of an economic recession in front of us, so the risk of a project cancellation, something you have on your backlog, or in your pipeline, is much greater. I personally have had the experience of doing a job in the past with our best job ever, that probably represented 60% of our gross profit for the period we were doing that job, got canceled for convenience about 10% in.

How your contracts read is important around cancellations, and cancellation for convenience. Make sure you're aware of what those are, and hopefully it doesn't happen to you, but that risk is out there. The next thing I want to talk about is a balance sheet risk. Again, this may be something you haven't quite thought of, but with these increased project prices, a lot of you have more backlog than you've had in a while, or than you've maybe had ever. Well, if your revenues are increasing, your equity needs to be increasing too, to go up with that risk, and the cash flow needs involved. The other thing is if we do hit a recession, be ready for your accounts receivable perhaps to worsen; which, generally does happen in going into a recession is all of a sudden money gets tighter, and people don't pay as timely.

The other thing that happens in a recession is it becomes more and more difficult over bill. If you look at your cash position, you got to make sure your equity position is right, and it can handle perhaps some interruptions in your receivables. And the amount that you've been able to over bill before. Those are sort of two hidden things to watch out for. The last risk I want to point out to everybody, and this may only apply to a few of you, is development risk. For those of you that are involved in development, as well as construction, or are just investing in development outside of construction, remembering back to last recession, we had quite a number of clients who suffered from their bank guarantees. In particular, one to watch out for is the language joint in several. All right? We've had a lot of successful years in construction.

Hopefully all of you have as well, but a lot of that can get swept away with one bad guarantee, or a guarantee that involves joint and several responsibility for a loan out there in development. I want to caution you on all of those and be careful with all of those. What to do about this rising risk? Number one, dust off and ramp up your go, no go reviews. That's going to become more and more important that you don't have a project go south once things start to tighten up. Number two, contract review and contract negotiation, and contract commitments. Again, with supply chain issues and price issues, those become more and more important. You want to make sure you're protected. And that, again, your seat in the game of musical chairs is protected, so when something goes wrong, hopefully it doesn't all fall on you.

Number three, there are lots of risks out there in our projects right now, again, because of supply chain issues. Make sure each project you identify and manage those project gotchas. I think, again, project loss becomes more of a risk as we get in a tightening environment. You want to make sure that you're, in pre-construction in particular, you're attending to all of those gotchas. When you get your initial construction plan that you're looking for, all the areas that can go wrong. And hopefully you have a contingency plan to take care of that. Next, in your project choice, avoid the news. News as spelled, N-E-W-S. New geography, new client, new superintendent, new sector. Our tendency, when we get into a tighter environment is to try to expand where there's more work, but oftentimes that's works outside of our wheelhouse. With that comes a lot of increased risk. Those factors I mentioned, any one of them can cause a project to go south. But if you have a combination of those, you really have increased your risk by a multiple.

Finally, with regard to rising risk, a willingness to say no. No to a contract term you don't like, no to a project that may be too risky. Even no to a customer that's asking you to do something for them. When I say a willingness to say no, I mean that even at the risk that the alternative is getting smaller. There's a lot less risk in doing good work and getting smaller, than there is in doing risky work and trying to maintain your rate of growth. Or even trying to maintain the same size. Take stock of the risks that are in front of you. Make sure you're taking the steps to look at those.

Dennis Engelbrecht, Digging Deeper.