Hello everybody. Dennis Englebrecht with The Family Business Institute, Digging Deeper.

For the last couple of weeks, we have been talking about the new abnormal. The new abnormal is this world of supply chain disruption and pricing craziness that we're experiencing right now across the construction industry. And today I want to talk about the risk side of this. Trying to manage your risks to make sure you don't get stuck with the problems that are prevalent throughout construction right now, because of pricing impacts and supply chain disruption.

To manage your risks, we have to think of the construction business in general. I mean, in the good years, construction makes four or five percent. Of course, right now the materials, inputs to construction have risen by more than 20% year over year. With a 4% margin you cannot be absorbing 20% changes in pricing, that's in it.

Plus, of course, we're tied to a schedule. Usually by contract, in order to get our work done and get our jobs done. And if you don't get them done there are costs. General conditions, sometimes liquidated damages, worse of all consequential damages that could be out there. We've got to stay on time, and we've got to be careful that with all of these inherent risks of doing work today, we're able to pass those risks on.

Just a few tips out there. The first is, make sure you don't agree to something that's unrealistic. All right? Starting right at the contract level you're going to get tied to some sort of schedule. Well, make sure that whatever schedule you've put forth is realistic and incorporated in the master schedule, if you're on the trade side of this.

If you agree to something that you can't deliver, well, obviously you may suffer the consequences of agreeing to that. That's key number one. It is going to take longer to get projects done than normal, because along the line you're going to get some supply that is going to get disrupted and you're not going to be able to get it on a normal basis.

If those things aren't too critical or on the critical path, you may be able to overcome those, but you certainly need allowances at this time. And I've even heard of contractors getting allowances for schedule put in to their contracts at this time, because in a lot of cases there just are a lot of unknowns out there and you don't want to get stuck with the unknowns.

The next thing of course is, looking at your contracts very carefully and making sure that if there is pricing changes that you're unable to lock in from below, you've got some movement perhaps, in your contract. Either allowances, contingencies, or you've just put some extra money in anticipating prices that you can't lock in today.

Very important that you look both downstream and upstream for those contractual things. Again, as general contractors with your low margins, it's impossible for you to absorb the bulk of these price increases after the contract, so you've got to make sure that you've got everything locked in.

And if you're a trade or supply, or downstream of course, you've got to make sure that you have those things locked in or have an opportunity to pass things along. Number three. Bonding. For the general contractors, you want to make sure that you are bonded in this period, more so than other times, because there is certainly the chance for subcontractors to get caught in a position where they can't deliver on their contracts.

And while they don't want that to happen, the craziness around pricing, you could be locked into a contract and all of a sudden there's a pricing change that is so extreme, that you clearly can't deliver on it and stay in business. And you think, "Well, geez, how could it be that bad?"

Well, as I'm talking today, we're looking at lumber and steel prices that are three or four times the average over the last five or 10 years. So, if you've got to deliver on something that's three or four times your contract and you're used to a five% margin at best. Well, that just doesn't work.

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Again, we got to make sure via contract or bonding, or whatever, that we've protected ourselves. And then buyout. We've got to make sure if we get a contract, we immediately do buyout. Generally speaking, it looks like owners and even financiers are being able to provide the funds to do buyout early, to have more in stored materials.

Again, that seems to be the smart way to approach the construction business today. You definitely want to make sure things are bought out immediately, and they're locked in. All right. And finally, one of your best risk management tools today is saying no. All right? You're definitely going to get confronted with some situations that have more risk than you probably should take on. And if the customer ultimately is not able to absorb that risk, perhaps the best thing for you is to say no and live to play another day.

Again, Dennis Engelbrecht. Digging Deeper.

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