FAMILY BUSINESS INSTITUTE

Hi everyone, this is Wayne Rivers at FBI, and *We Build Better Contractors*.

This week, I want to talk about planning for an uncertain economy. Is the US in recession? I don't know. I think we should probably leave that to the politicians and the academics and all those people. We know the commercial construction is not in recession. We know commercial construction is 12 to 18 months behind the regular economy. It's a lagging industry, which is good in a way. Maybe by the time construction feels the pinch of recession, maybe the economy will be on the way up and we'll have just a little hiccup in construction. But who knows?

Why is this important to you? Well, golly, you've really got to be thinking about, okay, we're going to have a great '22. '23 looks terrific on paper. What's beyond that? So, as we were talking about the construction economy, in our last strategic planning meeting, Dennis went through three different examples. The first is current day. Let's just use hypothetical numbers here. Let's just say it's $100 million contractor with a wonderful, beautiful 10% gross margin. That contractor right now creates $10 million of gross profit. $10 million of gross profit, you can do a lot of things. You can pay some bonuses, you can contribute to your retirement plans, you can distribute money to the shareholders, you can spend capital money. I mean, 10% gross margin is wonderful, and that throws off a lot of money. It does a lot of wonderful things for your people.

The second thing, let's go through this scenario. Now, we had this dramatic spike in input prices. Everything just inflated at one time. It was unprecedented and ahistorical. Well, Dennis theorizes that the price drops may be probably not as precipitous but can be quite precipitous. So, let's think about that for a minute. For in particular GCs, where so much of your revenue's pass-through revenue, if the price of all your inputs drops by 20%, now your 100 million gross volume might be 85 million. So, let's say it's $85 million, and you can see the example on the screen, and you've still got that wonderful 10% gross margin, now you're at 8.5 million of gross profit. Okay, that's less, but still pretty healthy.

Now, let's think about this. The economy tightens, and margins get tighter because competition is greater than it was before. Now that 10% gross margin is pushed down to 7% gross margin. So now you're at 85 million because of the input price reductions, you're at 7% gross margin because of the increased competition. Now, you're right at around $6 million of gross profit. You've got to be looking hard at that. Can you cover your overhead? If your gross profit is down from 10 million to 6 million, at that level, can you cover overhead? And if so, do you have a lot of coverage or a little coverage? How much money are you as the owners willing to put into the company to keep things status quo? You've got to be thinking about those things.

Now, two-thirds of our members are general contractors, vertical builders. And especially for vertical builders, but also for other types of contractors, the biggest single cost is people. All right. So, if you're down at a point where maybe you're not covering gross profit and your biggest cost component is people, you've got to be thinking about, what am I going to do if we get into a tight economy, serious competition, and this tightness continues for 12 or 15 or 24 months? What am I going to do? What I'm going to suggest sounds a little harsh, but one of our consultants, John Stump, suggested this in our strategic planning meeting, and I think it has some merit to it.

He says, "Stack rank your employees." You can look this up, stack ranking. It's a thing Jack Welch created at GE ages ago in the '80s. It basically puts your employees, you take your top 20% of employees, and it's a curve, top 20%, bottom 10%, and then the 70% in the middle. And you're always evaluating. Now stack ranking has some pros and cons. Some people are just absolutely against it. They say, "It creates internal competition. It distracts people from the mission of the company because they're always looking over their shoulders. Am I going to be ranked higher than that guy across the hall over there?" And it can hurt morale, especially for the people that think they're going to be here on the rank and they're not. First of all, I would say this should be a management tool, not something that's shared among your employees. I think that's the first key.

Now, the pros of stack ranking are, it does emphasize the concept of meritocracy. Construction business is nothing more than a meritocracy if you look across the entire industry. It's clear, and that's the main thing. If we get into a protracted economic contraction, you need clarity. Subjectivity is the enemy of leading people. And finally, it can increase morale. For example, your high achievers, you want to keep them super motivated. So, if they know they're able, because of clear job descriptions, clear metrics, they're able to do X, Y, and Z, and earn this kind of money, that helps them with morale, helps them know they're hitting their targets and they're going to be financially rewarded for the targets. You cannot have subjective evaluations of your people. There's got to be some way to measure them in the jobs that they do. And stack ranking is one way of doing that.

So, I'd like to know, what are your best practices? We've been through the awful recession of, whatever it was, 2008 through 2012. Whatever you think it was, it seemed to affect us all quite differently. What did you do then? What was successful? I feel like most of our contractors got caught flat footed. They did not have plans. Because we're a lagging industry, contractors fooled themselves into thinking, ah, this recession is not going to hit commercial construction. It did. Most of our members had 40 to 50% volume drops, and most were caught flat footed. They didn't know what to do. They didn't know where to cut. It was a mess. So, you need to be thinking about those things now, and you need to have a plan in place, a contingency plan. If competition gets tough, the economy's contracting, margins recede, what are you going to do to cover your overhead and keep your best people? We'd like to know what works for you. Don't forget about Boot Camp. That is February 9 and 10. 2023. Get your folks signed up early. This is Wayne Rivers at FBI, and *We Build Better Contractors.*