which gave them a numerical score that accurately measured how the firm's prior experience lined up with project requirements. The results were consistent: the program is a predictor of the potential success of the project. It is suggested that potential users of the program do the same three-project test to gain confidence in its use.

Impact on Overhead

It may be obvious, but worth exploring: If you screen out losers, sales will fluctuate, however profit and efficiency go up while business risks go down. While overhead should always be carefully managed because construction is a cyclical industry, fluctuating sales make this even more important. The successful contractor of the future will be profitable in good markets and bad by adding some science into the management of his or her business. The drive for size and growth will be substituted with a drive for prosperity--measured in profitability. This can only be accomplished by not taking losing jobs which is accomplished by prudent project selection which requires judicious management of overhead. For many this will be a paradigm shift because the current growth model supports growing overhead means growing capacity. Prudent project selection does not stunt growth is simply redirects focus on growth of profitability. It will be helpful to review the concept of Flexible Overhead

Managing Overhead

Flexible Overhead addresses the misconception that you can't get half a person, half a truck--or half of a piece of equipment. You can. The concept is to have 15% to 25% of all overhead expenses engaged in a way that they can be turned off within a week. This portion of general and administrative expenses (overhead) are not taken on as permanent expenses, but as flexible or temporary expenses utilizing rental, temporary personnel, interim office and/or shop space and other quick-response solutions. Further information can be gained through a review of ENR Viewpoint articles published in the last two years. Initial reactions may be to suggest: it is impractical; too expensive; temporary persons are less qualified; it is cheaper to own than rent; and so on. We can't keep going the way we are because too many construction enterprises give back in losses during bad years what they earned in good years. The extra costs of Flexible Overhead, if any, are simply low-cost insurance against times when overhead can't be reduced when it is not needed.

The Advantages

If you have control of overhead, you have the luxury to select only projects you are experienced with and to dramatically reduce the number and severity of losing projects while maximizing profits. Some projects just don't fit. A reality check: Is there one project from any prior year that you wish you hadn't taken? If the answer is "yes" you are, in effect, saying that your preference is to have a smaller size company that year with more profit. This makes it harder to argue against bringing more science into a construction enterprise.

Construction Market Cycles

Prospering in Cyclical Markets (Back to **Table of Contents**)

When a construction company's backlog falls off, the pressure is on and it feels like a recession regardless of the actual definition of the word. Prospering in cyclical markets and surviving a "recession" starts with recognizing what will happen in the marketplace as soon as a market softens. The result is totally predictable and has occurred without fail in every industry down-cycle for the last 70 years.

When there are fewer projects in any market, competition intensifies and prices and potential profits diminish. The ideal in a shrinking market would be for each contractor to accept proportionately less work so that market share of each business is maintained. However, there is a tendency in our industry to resist any reduction and to fight vigorously for the fewer available projects, driving down prices for everyone. Trying to maintain volume in a declining market is, in effect, an attempt to increase market share and any increase in market share is universally "bought" at a cost.

Contractors resisting a reduction in their sales will, in effect, "load up on cheap work" which increases their risk in an already difficult circumstance. Conversely, cooperating with the market and downsizing to align your organization with market realities is appropriate management of the risks imposed through an environment outside of your control. We cannot control the market, but we can control our response to it.

The potential for profit, measured as a present of sales, is almost the same during a down market as it is in an up market—just more painful. The contractor's responsibility is to react to and manage risks in either case. This includes taking the difficult steps to downsize including rapid reductions in overhead. Risk control mandates these steps be taken sooner rather than later. The largest by far of all overhead costs are employee salaries. While cutting back non-essential costs such as subscriptions, bonuses, travel and entertainment, etc., is appropriate because it signals to employees a new attitude, it never amounts to enough to really matter. Reduction in overhead requires a proportional reduction in management and administrative personnel.

I regularly hear from contractors: "I can't operate with 10% or 20% less work. I have a 'drop-dead' volume I have to maintain to be viable." My response is: "As you grew your business from five and $10 million on your way to $15 million were you profitable at five and $10 million?" Most contractors were. The point is, if you have to go back to one of those reduced volumes, you need to size and configure the organization to exactly what it looked like when it was profitable at that size. This also includes reducing equipment resources by selling; or mothballing them if sale is not practical, but costs associated with them must be minimized or eliminated.

There is a tendency to hold on to people and equipment in order to be prepared when the market returns. However, unless you expect a very short downturn, there is serious risk that resources will be retained at great expense only to be let go at a future date; or worse, that the drain on the organization may make it difficult or impossible to finance recovery when the market rebounds.

The market always returns but accurately predicting the length of a downturn is difficult, and the primary objective should be to profit during a downturn.

Capturing, training and retaining good people has been a major issue for many contractors during the recent good years and serious resistance to these suggestions is understandable. However, timing is critical because there are real and significant costs to reacting late. One consolation may be that during a downturn there will be a glut of equipment and people available, and if there is an early rebound, resources will be available.

Owners of construction enterprises must react to that which they cannot control with processes which they can control. Unfortunately, the appropriate reactions range from difficult to distasteful. It is difficult but necessary to keep emotions out of business decisions particularly because there is no minimizing the reality that someone has to look people in the eye when they lay them off. It might be well to remember that managing risks to the organization protects the jobs of the larger number of employees that remain. Downsizing also provides an opportunity to weed out weaker employees and profit from doing a reduced volume with an organization's best people. It is entirely possible to prosper during this down cycle and to maintain financial strength which will be critical when the rebound occurs.