By Thomas C Schleifer, Ph.D.

Because Risk Is In Your DNA

I have a saying: Every time a contractor signs a new contract, it is as if that company was opening for its first day in business. That saying is especially relevant now. The construction industry is operating in a new post-recession landscape, characterized by tighter margins and serious labor shortages with less room for error. The unprecedented market downturn had weakened some construction organizations to the extent that they may have difficulty financing the growth that comes with market recovery. Now more than ever, owners, contractors and designers need to increase risk awareness and understand that construction business failures are worse during market recoveries than during market slowdowns.

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There is risk in any commercial transaction, but construction has more than its share. Designers avoid it, owners prefer to pass it along and contractors absorb it. To contractors, risk is not a dirty word. After researching the causes of contractor failure for more than thirty years, I have uncovered a noteworthy truth: The assumption of risk is part of every successful contractor's DNA.

Today's construction risk environment is drastically different from what it was even ten years ago, and the attendant risk factors are mutating just enough to be almost unrecognizable. The obvious risks are skilled labor shortages, subcontractor strength, capital availability, contract language and growth in general. It doesn't help that owners perceive construction as a commodity.

Management decisions will continue to determine whether an organization will be successful in the current business environment. The decision-making process includes beliefs that must be reexamined in light of this new normal, such as growth is always good, some unprofitable jobs are unavoidable and past success implies future success. These should not be embraced by the contractors that will react quickly to evolving markets.

The reason each new contract is like a first day in business is because every time a contractor starts a new project, it voluntarily assumes risks that are not fully identified.

Risks cannot be eliminated, but they can be mitigated if identified, measured and understood. Easier said than done, of course. Because the parties see their part in various risks differently and too many risks are attributed to more than one entity, making identification difficult, elimination impossible, and mitigation the only viable alternative. Quantifying and managing the risks pose a big challenge for owners, contractors, sureties, bankers and designers.

Critically, the contractor of the future needs to learn an entirely new skillset to recognize risks hidden in the market, in their own management decisions and in the economic climate. Too often what looks like good news has the potential to be hazardous.

That well-prepared contractor will establish formal risk assessment processes and protocols and adopt a strategy of flexible overhead that can easily adjust to a cyclical construction market.

When the market changed from contraction to expansion, unexpected and unrecognized risks were introduced. In this "new normal" environment, hanging on to old beliefs became more dangerous than ever. At a time when they will need to spread their skilled labor force too thin, construction enterprises, having been forced to downsize, now need to hire new people who will be unfamiliar with their methods and bring only limited experience. Some will find that they lack access to enough capital and that buyers have sharpened their contract negotiation skills as construction continues to be viewed as a commodity.

The boom may be back but conditions are very different. ■

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