

Letting Go Of Overhead

Too many construction organizations become slaves to their overhead, their general and administrative expenses. Increased overhead usually equates to increased capacity and is common and appropriate during growth periods. Unfortunately, these expenses are much easier to put in place than to get rid of, and in a cyclical market they become a burden and create losses. This is especially true now that we have such a weak and slowly developing business upswing.

A common reaction in a declining construction market is to search for work in unfamiliar markets—new geographic areas and types of projects—in order to hold the gradually built organization together. This combination often cuts profits or leads to losses. A declining market obviously poses risk for a construction organization, but dealing in unfamiliar markets simply magnifies the risk. And it's dangerous to combat risk by taking on more risk.

Think about how missing just a few consecutive ideal projects, which can happen even in a growth market, plus delayed project starts, can weaken your finances. Contractors are often tempted to look in other markets to maintain volume rather than cut overhead. Some have said they were forced into unfamiliar territory, when the reality is they never considered reducing volume (and capacity) to adapt to market realities.

A far superior and much less risky strategy is to chase and produce work within the organization's proven track record. When that type and location of work declines for any reason, reduce overhead in order to maintain continuous prof-

itability. In this way you can manage your risk to achieve success rather than react to changes.

I fully realize this is a huge paradigm shift from the often-heard standards: "If you're not growing you're going backwards" or "I have got to keep my organization together for when the market comes back." My answer is, "At what cost?" This recent sustained, lengthy and painful down market has shed light on the reality that excess overhead costs have weakened numerous construction companies, which does little to prepare the company for when the market returns. The current weak recovery is just making it worse.

Flexible Overhead

The answer to this problem is a new strategy I call "flexible overhead." Some companies already use it although not necessarily under that name. These are firms that are smaller (in some cases a lot smaller) than they were four or five years ago, but have remained profitable. They obviously do not earn as much money as when they were larger, but they do not give any back either. There is a much larger group of firms that have lost money.

What I am proposing is not nearly as painful as downsizing. Under my concept of flexible overhead, contractors should engage a percentage of all overhead costs in

such a manner that they can be turned off and the expense ceases in a week or less—in some cases, in a day. They are not taken on as permanent expenses but as rentals, temporary personnel, interim office space, etc. The percentage range varies up to 25% because each organization is different.

I have already heard complaints that this is impractical and too expensive, that temporary personnel are less qualified and it is cheaper to own equipment than to rent, and so on.

To this criticism, I say that the market we deal in is cyclical. Continuous growth in sales as a business model is impractical, high-risk and dangerous. A concentration on growth in profits rather than sales makes more sense. When maintaining size is the chief motivator, overhead tends to grow. When growth in profits is the primary focus, selection in projects shifts from a desperate need for sales to what the organization does best. Team members still have job security because flexible overhead will preserve the company and its staff. A company that concentrates on profitability, not size, has a totally different understanding of the market and its place in it. It still enters new markets, but with careful attention to how much it attempts, what the risks are and whether it can afford the learning curve. A new definition of the successful contractor of the future has evolved.

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