FEATURE

Survival Strategies Amid COVID-19

by Michael McLin, Maxim Consulting Group

Introduction

The COVID-19 pandemic has had far reaching impacts on the U.S. economy. Companies in once successful industries across the United States have felt the immediate impact of the current pandemic in the most devastating ways. Since March 2020, many companies have come to a complete and total shutdown, displacing more than 25 million Americans from their jobs. Other industries, such as the healthcare and medical research fields, have seen excessive stress placed on them not only in terms of resources and equipment, but also on the personal lives of the professionals administering these services. These are truly unprecedented times that were unforeseen just one year ago.

The federal government has tried to do its part to care for the unemployed, the small businesses, and even some large industries that have been most noticeably impacted by the government-directed shutdowns and forced isolations of our population. The CARES Act has gone a long way to help start bridging the gap from today toward recovery. However, unemployment remains high with nearly one million people a week claiming unemployment benefits.

It could be months or, in some cases, a few years from the start of this pandemic until we see construction companies fail. It will happen because they have no clear channel for equitable adjustment and have been contractually mandated to continue operations. The new normal being created from pandemic-driven health and social modifications is being seen all over the construction industry. There is also widespread belief in the industry that pandemic liability will be pushed down contractually leaving the burden on the very businesses needed to complete complex construction projects.

The construction industry thrives on challenge and innovation and will continually improve to deliver products

The Construction US Economy At-a-Glance

	12/12	12MMT	Current 12/12	2020	2021	2022	Highlights
US Single-Unit Housing Starts			6.3	0.3	18.8	4.4	Leading indicators corroborate our outlook for robust 2021 growth; expect overarching growth to persist through at least 2022.
US Multi-Unit Housing Starts			12.6	1.5	-7.5	12.5	The Starts 12MMT is expected to decline into late 2021.
US Private Office Construction			1.5	-11.5	-20.6	2.4	Construction will decline into mid-2022. At the low, spending will be about 32.0% below the pre-pandemic level; plan accordingly.
US Total Education Construction			1.9	-2.8	-4.2	3.2	The Primary and Secondary Education component ticked down. Expect 12MMT decline in Total Education Construction into 1H22.
US Total Hospital Construction			0.1	0.6	-4.2	0.8	We revised the forecast upward through 2022. Expect growth into early 2021 before decline takes hold and extends into early 2022.
US Private Manufacturing Construction			-0.9	-16.0	-20.0	16.8	Construction entered Phase D, Recession; 12MMT decline is expected to persist into late 2021.
US Private Multi-Tenant Retail Construction			-24.5	-19.0	-14.6	10.8	The Construction 12MMT will move below the Great Recession low in the coming months and be below the current level through 2022.
US Private Warehouse Construction			12.3	17.7	6.5	9.9	We revised the forecast upward for 2020, 2021, and 2022. Expect growth to persist through at least 2022.
US Public Water & Sewer Facilities Construction			12.5	3.8	-9.5	3.2	Funding constraints will likely keep both 2021 and 2022 Construction spending below the 2020 total.

Note: Forecast color represents what Phase the market will be in at the end of the year.

PHASE KEY

Phase A: Recovery

Phase B: Accelerating Growth

Phase C: Slowing Growth

Phase D: Recession

safely to owners. In time, firms will adjust to this new normal and price the contracted work appropriately. However, in the near term, the industry's financial burden from the social restrictions placed on it may be so great, that many companies will not survive to compete in the future.

Economic Fallout

Multiple studies completed by Maxim Consulting Group and commissioned by ELECTRI International and New Horizons Foundation have discovered a nearly 20% negative impact on contractor productivity. Both studies are available for download at no cost on the ELECTRI and New Horizon Foundation websites. A rule of thumb for self-performing contractors is a 10% decline in productivity equates to a 100% decline in profitability. This puts the magnitude of a 20% productivity loss attributable to COVID-19 into perspective. The strong economic runup to the pandemic means many contractors have solid balance sheets. That hard-earned financial strength quickly erodes when matched against the magnitude of the impacts on the MEP Trades discussed.

Most contractors have indicated they expect minimal amounts of COVID-19 related cost recovery. Few owners are reimbursing them for costs incurred due to COVID, so general contractors and subcontractors have limited options. Further, cost recovery is a much more sensitive topic with negotiated clients than in the hard-bid world. For many contractors, PPP Loans helped keep their staff employed and protected the balance sheet and profitability of the organization, however, the loans are largely consumed and expected to be forgiven.

Making matters worse, construction is a lagging industry that tends to feel economic impacts 18 to 24 months after the general economy. The stock market's performance is nothing short of remarkable considering the looming economic impacts from extended closures and underutilization. Contractors are seeing project opportunities dry up and backlogs shrink. This pipeline of business is felt most severely within smaller organizations that tend to have a smaller average project size. Larger contractors anticipate big projects will carry them through 2021, but opportunities for 2022 are dwindling.

ITR Economics released their October 2020 economic forecast recently (shown in Figure 1) and it is clear the widespread decline is expected to continue into 2021 which will impact backlogs on a broad basis.

Survival Strategies

To survive the impending downturn, contractors should consider a variety of strategies. No single strategy is likely to be the answer, so it may well be a combination of approaches. Some options to consider include:

- Prepay anything you can. For example, rent, utilities, property taxes, software licensing fees, personal protective equipment, professional services, disposable tools like battery drills, etc. Anything you can pay for now while you have the cash should be considered.
- Align your overhead to your volume demand curve. Contractors have historically been notoriously late cutting overhead costs when volume is dropping.
- Get LEAN. Eliminate waste, streamline your business processes, and prepare to do more with less.
- Retrench and wait out the storm.
- Add a new service line, particularly anything that helps companies and industries address COVID-19. An example would be for HVAC Contractors to offer facility air quality analysis for potential system upgrades or changeouts.
- Offer customer incentives to proceed with planning maintenance of capital expenditures. This might include extended warranties, first year of maintenance included, multi-year maintenance agreements, and other like strategies.
- Consider a merger or an acquisition with a firm that offers complimentary services. Ensure the cost efficiencies are leveraged through back office department consolidation.
- Add a geographic region to expand your customer base.
- Consider joining an industry-focused peer group where the "wisdom of crowds" can effectively evaluate your plans and provide advice.

There is little doubt the economic fallout is coming. There is widespread discussion of a GDP Decline approaching 6% in 2020. To get a sense of the level of decline, one must only think back to the great recession of 2008 when GDP dropped 4.8%. Many contractors are having record years in 2020 thanks in part to PPP loans and a strong backlog, but unfortunately this is not sustainable.

Conclusion

COVID-19 has created new and very unique challenges for contractors. Adjusting to the new normal will require changes in strategy and a recognition of the timing of the economic decline for contractors. Act now while all your options are available to avoid getting caught later.

About the Author

Michael McLin is the Managing Director of Maxim Consulting Group responsible for leading the business and guiding the strategic direction. Michael works with construction related firms of all sizes to evaluate business practices and assist with management challenges. Michael is a nationally recognized, dynamic public speaker and published author. If you have additional question, you can contact Michael at ***michael.mclin@maximconsulting.com*** *or* ***www.maximconsulting.com****.*