The Outlook for Family Construction Firms in the Mid-90s:

Survival Increasingly Depends on Adopting Tough Business Practices

By David Gumpert & Peter O'Neil

The late 1980s and early 1990s were certainly difficult times for firms in the construction industry. Many have emerged damaged or smaller—and some did not emerge at all—as the recession hit the construction industry especially hard.

Less certain is what type of environment awaits these firms as the mid-1990s unfold. A one-word description of that environment might be “Darwinian,” with the fittest, best adapted and most fully evolved family-owned construction companies being the ones who will rule this new era.

The new environment will still contain many of the same hostile elements of the recent past: Customers who are slow to pay; financial institutions that are hesitant to lend; potential clients with greater leverage; and continued competition from large firms that formerly had fished in bigger ponds.

The successful 1990s family construction firm will overcome these elements by adopting more formal business practices. They will minimize risky business practices and be able to track nearly every expense item in precise detail. Many will have to develop a reputation for quality or “niche” specialties that set them apart from larger competitors. And they will have to come to grips with the difficult issues like succession and estate planning that every family business dreads to face.

Increased Professionalism

The companies that survived the lengthy downward cycle did so by cutting costs and becoming much more efficient in their operations. Many of the survivors are family owned enterprises that have become increasingly more “professional” in their operations. These closely held businesses are moving away from their past tendencies to operate in a relatively informal manner and are beginning to more closely resemble their larger brethren. This evolution—in true Darwinian fashion—has been one of necessity.

“If a closely held family business in the construction industry has survived the storm of the past few years, the chances are pretty good it has emerged as a lean and mean company,” says Andrew Stem, an attorney who works with construction industry clients for the Boston office of Epstein, Becker & Green, a national law firm based in New York and Washington.

“They’re running their businesses—many for the first time. The need for survival has dictated that. And many have developed a niche or some sort of specialty that has allowed them to survive, and now may allow them to thrive.”

Joseph Astrachan, a professor of management and Entrepreneurship at Kennesaw State College in Georgia who studies family businesses, says smaller family firms in general are beginning to “get it” when it comes to adopting more formal practices and seeking outside help.

“A lot of smaller firms are parochial about seeking outside advice,” says Astrachan. “Their misimpression is that they don’t need help. They often say, ‘We don’t need these people; we can do it on our own.’ Well, that’s naivete. There are no great leaders who can do it on their own.”

Astrachan says a recent survey
of 614 family business owners done for the Massachusetts Mutual Life Insurance Co. indicates a trend toward professionalization among family firms.

“As the younger generation moves into positions of authority, you should see more of a shift toward professionalization,” says Astrachan. “They'll either professionalize, or they'll go out of business.”

PROFESSIONALIZE, YES—BUT HOW?

The general admonition to “professionalize” does not mean a construction company can adopt a policy here, hire an adviser there and, presto, turn a profit. Rather, professionalizing means adhering to stringent guidelines that require constant diligence.

Jeffrey Folan is a Certified Public Accountant and partner who works mainly with construction company clients of Kennedy & Lehan, an accounting and consulting firm in Quincy, Mass. He echoes Stern and Astrachan's observation that the need to operate within tighter and tighter margins has left many smaller construction firms with minimal excess costs. With little or no “easy savings” left to be achieved, quality and efficiency have become more important then ever.

“We try to make our clients aware of the importance of controlling general administrative expenses,” Folan says. “At this point, most of our clients have already downsized, or right-sized-what ever term you want to use. There's been a focus on looking at cash flows and a much closer eye on financial statements.”

These financial statements are especially important when firms seek financing, especially from banks that have become increasingly cautious. “The banks and bonding companies feel more comfortable if there is someone on board preparing the financial statement who understands contrac-

tors, understands how the industry works and knows the issues that are involved.”

“Unfortunately, a lot of banks had the Federal Deposit Insurance Corp. come in and say ‘Contractors are high risk Get them out of your portfolio. Get rid of them.’ A lot of banks will not be willing to work with contractors.”

Folan says firms are bidding for jobs on much tighter margins. “There isn’t a lot of room for error in the estimates,” he says. “There is work out there, but it’s very competitive.”

Construction firms can benefit from professional advice that allows them to make more fully informed bids. Benefits include a better handle on the tax implications of buying vs. leasing equipment; a more reliable estimate of overhead costs related to employees; more accurate financing cost estimates; and better cash flow management.

“I wouldn’t go so far as to say any adviser can make or break a construction company; it’s still the owners who determine that,” Folan says. “But at a certain point and at a certain size, a company owner can’t do it on the back of an envelope in his back pocket anymore.”

“Our advice often sounds like simple things, but with margins as tight as they are, having some formal procedures helps people get focused,” says Folan, who cites the specific example of the side benefits of tax planning.

“By helping with tax planning we can help with cash flow. Not only can we help save on the current year’s taxes, but companies have to pay the next year’s estimated taxes based on the previous year’s results. So, it’s like a double savings in cash flow.”

DEVELOPING NICHE MARKETS

Of course, no matter how efficient a business becomes, this well-oiled machine will sit idle if it can’t find a market for its services. When it comes to seeking new markets, the creative construction company will be rewarded, says Andrew Stem.

“The environment will be good for construction companies that have a niche,” Stern says. He offers the example of one of his construction clients that has developed a specialty in constructing space for banks or other financial service companies that have changed their technology and need to make adaptations in their space.

It’s a wonderful 1990’s company,” Stern says. “They’re doing quite well.”

Folan knows of firms that have taken a long, hard look at demographic and population trends and are developing specialties in such emerging areas as long-term care facilities that will be needed to service an aging citizenry. Others are seeking to specialize in specific health care areas.

The development of such specialties has been further encouraged by the entry of large construction firms into markets they had formerly eschewed as too small. The slower business climate has drawn these big firms into competition with smaller companies and increased the competition for contracts.

“Large firms are chasing business they never would have considered in the past,” Stern says. “The smaller companies are now having to compete with them.”

The presence of these larger firms is yet another factor that provides added leverage to customers. “In the old days,” says Folan, “there was so much work out there some firms could say, ‘Hey, you don’t want to meet my price, see you later.’ You can’t do that anymore; you have to work with them.”

SUCEEDING AT SUCCESSION

One formal business practice that has long plagued family businesses is the inability to handle the process of moving from one gen-

January 1994/Construction Dimensions
eration of management and/or ownership to the next. This is especially true in construction, where the company's biggest asset is often the expertise, reputation and active participation of the owner.

In addition to his faculty position at Kennesaw State, Astrachan is also the associate director of its Family Enterprise Center and an adviser to family firms. He sees evidence that family firms are beginning to understand the importance of planning for succession and acting more in accordance with their needs.

Astrachan says the MassMutual survey revealed an increase in succession planning activity at companies that are older and larger. Of the respondents to the survey who were over the age of 50, nine out of 10 had chosen a successor. Perhaps more importantly, these owners had informed other people of their choice, an action that greatly enhances their chances of having a successful generational transition.

“Somebody is getting to them as their businesses get older and larger and convincing them that they have to think about succession planning,” says Astrachan, who also notices an upswing in other formal practices, such as written business plans and formal rules for entry and promotion.

This may be an indication that family firms are taking advantage of the increased availability of planning resources for family businesses. Companies like MassMutual are doing extensive research into the family business market, and also sponsoring university-based family business centers where family firms can benefit from the advice of academics such as Astrachan and other professional advisers.

“I think they are just beginning to get it,” Astrachan says of business owners. “If the survey had looked back 10 years, we would’ve seen much less formal behavior.”

“Businesses are beginning to see that some of the scrutiny that goes along with these procedures is good. More accountability, more scrutiny, more formal policies—all are more of an advantage than they had thought. People who are willing to put themselves under scrutiny are often doing better than those who won’t. And with any luck, they’ll be doing more of it.”

About the Authors
David Gumpert & Peter O’Neil write about small and family businesses. Gumpert is the author of How to Really Create a Successful Business Plan and How to Really Create a Successful Marketing Plan (Goldhirsh Publishing).