

Second Crisis-era Message to Contractors from: Dr Tom Schleifer

Immediate Measured Response

How Long? In my first “Crisis-era Message I said: “How long this will last is exactly what we need to know in order to formulate a response.” We have choices when facing the unknown: do nothing or make estimates based on *informed approximations*. The responses I am receiving suggest most contractors intend to wait and see—justified by the unknown. (Default to inaction) Nothing on the news suggests anything is getting better so my prior recommendation to plan for 90 days should be considered a minimum. If the virus incidence curve reduces, restrictions will be moderated; but will construction rebound immediately? The economic impact will extend far beyond any reduction in new virus cases. Can we measure the economic impact on construction?

Our industry follows the US economy which is suffering its way towards a recession at best and depression at worst. If the economy rebounds, how fast will construction rebound? Most of the construction in-progress will be completed, but pressure to conserve cash will cause some projects to remain postponed or cancelled. New projects already designed and funded normally go forward during an economic downturn, which is why construction has been a lag industry. However, the pressure to conserve cash may continue because the economic losses during this downturn, in theory, will need to be recovered before capital spending can rebound. Public entities will have suffered extreme reductions in tax revenues and private industry will have experienced severe losses from lack of activity. These economic engines were cash-rich going into this crisis but will not be so coming out of it. This means a greater reliance on debt to fund future construction which is far less attractive.

The pace of construction recovery may rely in part on stimulus funding to business and industry, which is uncertain and usually has to be repaid in some form. This combined with a likely reduction in business and industry’s appetite for debt, will impact the construction industry’s rate of recovery. The outlook: The beginning of a construction recovery will be measured in months and so the 90-day window is off the table. A construction revenue return to pre-crisis levels will not likely occur this year for lack of funding. We are left with limited choices: cut overhead immediately and continue to cut to the extent of any reduction in revenue; or wait to see what develops and cut overhead later after months of losses. Another important question is, will a slow recovery result in the destruction of profits from the pricing reductions we saw during the 2008-2012 downturn? This was caused by a determination to maintain a full share of a diminishing market.

I fully understand the reluctance to cut overhead which means people, particularly within weeks of suffering through a severe long-term labor shortage. Will you get the people back? Unknown. Depends in some measure on how you treated them while employed. How will you execute backlog? Some backlog is likely to evaporate, and incurring losses doesn't make completing work any easier. At times like this the fun goes out of being the boss. You are left with making your own *informed approximation*. Consider the shortest and the longest time that you believe a construction recovery can and will occur. I suggest taking the average of those lengths of time and deciding if the enterprise you are accountable for can and should incur those losses while keeping in mind the responsibility of *Protecting the Value of the Business*.

Note: Additional information on how to cut overhead can be found on letstalkbusiness.net. Click on "Manual" and go to Managing Overhead in the table of contents.

All new developments will be addressed in next week's Crisis-era Message