

13th Weekly Crisis-era Message to Contractors from: Dr Tom Schleifer
**The Dynamics and Patterns
of a Construction Market Downturn**

Finally: some light at the end of the tunnel. The US economy may have bottomed out and unemployment may have leveled, even improving some. I say “*may have*” because the Labor Department Jobs Report is subject to revision, and there were 15% fewer responses than pre-crisis. Accepting the report as is, there are still 21 million workers on unemployment so questions remain: How many jobs will the economy support? Will consumer spending recover anytime soon? When will small businesses rebound and will all of them survive? The economic news this week is spread from predicting a modest to slow rate of recovery with few, if any, expecting recovery this year.

Length of Recovery: The construction market lags the US economy. In spite of this certainty you may have seen a few articles in industry publications suggesting that “*construction can ‘lead’ the economy into recovery*”. However, they were politicians and industry people trying to promote federal funding for infrastructure projects. Even accepting the wishful thinking, most see there will be less construction put in place in 2020 than in 2019. The question is how much less? Forty seven percent (47%) of the construction jobs lost this far have returned, but that is still only halfway back. There is also little backlog coming forward as projects continue to be canceled for lack of funding and designing of future work withdrawn for lack of need. Obviously there will be a lot of work completed during the market decline. Just not enough to satisfy appetites after the growth experienced between 2016 and 2019. It is not in our nature to settle for less--downsizing to the amount of work available.

Profitability: Whenever there is less work margins suffer because the selling price of construction goes down as the industry shifts into a “*buyer’s market*”. Losses become more common, and some businesses eventually fail. No type of construction was spared in prior downturns because contractors with limited experience in other types of projects or with working in different geographic areas went after work they were not familiar with. Many were successful in capturing that work because they were aided in their pricing by a lack of experience or limited local knowledge. In the current circumstances there will likely be a reasonable amount of infrastructure and heavy construction work available that will attract companies burdened with a shortage of building projects. When the market shrinks, competition increases and the selling price deteriorates for every type of work as construction companies fight for work anywhere, any type (almost at any price).

The “*Compression*” Dynamic: [*Schleifer’s Dictionary of Business English*] *Compression: the domino effect of the downward pressure applied to construction pricing by large contractors during market contractions.*] What happens in a downturn is larger construction companies desperate to keep their people busy, aggressively go after smaller projects than they normally would. This takes work away from other firms forcing them to go after smaller projects than they normally would and so on through mid-size firms and finally down to small firms. With their greater capitalization big contractors are able to use aggressive pricing to take smaller jobs and/or expand geographically by moving into markets they do not normally compete in. The lowest level in this avalanche, the smallest contractors, have nowhere to turn and some are driven out of business.

Defense: Contractors need to understand this dynamic which happens every downturn and should therefore be expected. Compression highlights the reality that cutting the cost of doing business and downsizing is the only defense during a declining market. The only option is to cut overhead proportionally to the amount of the market decline enabling you to produce a lesser amount of work at

a profit. If there is less work available, and a firm attempts to maintain their sales volume they will have to take the work off their competitors who are trying to do the same thing. Compression causes industry-wide losses which is part of the reason that construction has the second highest business failure rate in the country. A failure rate that always accelerates during declining market cycles. This has been happening for decades and has not been recognized because it was an unknown and unidentified dynamic. Now that we know about it we can deal with it.

Market Cycles: As an industry we need to stop believing that it is automatic, almost acceptable, to lose money during a market decline. This happens so regularly to those who refuse to downsize and cooperate with a declining market that we have begun to think it is inevitable. It is not inevitable unless contractors persist in *fighting* declining markets rather than cooperating with them. We have got to stop thinking that we control the market. The construction market is independent of the construction industry and cannot be influenced by contractors. The construction market is a product of the US economy and results from the needs of parties outside of the construction industry for things to be built and the ability and willingness to pay for it. This is the business environment we work in so it is critical that we learn to prepare for and manage through the inevitable market cycles.

Reality: Market cycles and compression are very real and dangerous realities. Those who don't understand these dynamics and patterns will not recognize them when they occur and will not be prepared to react appropriately. You cannot fight the avalanche once it begins. The only way to *fight* compression is to continually lower your prices as larger competitors force their way into your market which causes losses you should not incur and may not be able to afford. What you can do is refuse to take work at a loss which means downsizing to cooperate with a declining market. All of us know to get out of the way of an avalanche because defying a landslide is a deadly choice. The only thing certain about the current market downturn and compression is that there will be others. Let's hope they are at least 10 years apart which is the average interval between construction market downturns since WWII.

To assure you will continue to receive the free weekly Crisis Message to Contractors, you will need to send your email address to tom@schleifer.com.

Note: Information on overhead management can be found on letstalkbusiness.net click on "Manual" and go to Managing Overhead in the table of contents.