

19th Weekly Crisis-era Message to Contractors from: Dr Tom Schleifer
Implementing “Flexible Overhead” Continued

The construction market downturn mentioned in the first crisis message on March 18, was projected in the second message to continue through the year and was defined in the third and subsequent messages as getting worse. Four months later, July 6 headline in ENR: “*Market Optimism Crashes in Wake of the COVID-19*”. Does anyone need more convincing--“wait and see” is no longer an option. History repeats itself and, as explained in several prior messages: (A) There should be no surprise that profits will suffer as the market declines, and (B) Fighting to maintain sales in a declining market invites huge risks and potential losses. Some have already cut overhead, others will follow, and some will absorb excess expenses for as long as they can. All these options are painful. I have experienced them personally and feel for those that are forced to make these difficult decisions.

Now is the time to recognize the benefits of flexible overhead and determine to use the process when you are finally ready to put overhead back in place. Those who use *flexible overhead* have been turning off these expenses quickly, easily, and painlessly whenever they are not needed. Since the development of the flexible overhead concept in 2014, the non-permanent portion of overhead is easy to increase and even easier to decrease.

The flexible overhead concept that was introduced in message 17 and the its implementation, explained in message 18, is continued here. The processes described last week for implementation in all office functions and departments is similarly used with the shop, yard, and field. Firms that fabricate portions of their work off site like HVAC, sprinkler pipe, etc., generally operate a shop facility. As their business expands, they typically enlarge the shop and add equipment, which is expensive and permanent, and when work slows, the costs continue. An element of the flexible overhead concept referred to as “the judicious use of overtime” is the alternative along with outsourcing. Many self-performers would never consider outsourcing a portion of their work, particularly to a competitor, but it is a valid method of dealing with short-term or initial uncertain expansion--and it works.

Overtime, often avoided, is a valid method to self-perform short-term opportunities or uncertain expansion. The standard objection: “*I can’t make money at time and half*” is in error. Numerous studies have verified that getting to and from the face of the work at the start of shift, breaks, lunch and end of shift, etc., means the productive time an eight hour day in construction (depending on the study or size of project) is plus or minus 6.6 hours or 82.5% productive time. An hour overtime is 60 minutes of work or 100% productive time. At two hours overtime the numbers get even better. There is a cost, but nowhere near the expense of putting on additional permanent overhead. The only appropriate time to put on permanent overhead is when expansion (growth) is reasonably certain to be long-term. Short-term expansion can also be dealt with by adding a second shift. Construction is generally considered a daytime activity and, because it is uncommon, few will even consider shift work. One approach is to use only a small hand-picked crew and, to the extent possible, do primarily the most repetitious work at night which utilizes the existing facilities and equipment to supplement the day shift. Deciding to try it is much harder than doing it. A second shift works as well in the field and the process is cost effective when utilized for permanent expansion. In both cases there is a cost, but not near as much as the continuous cost and risk of more permanent overhead.

Self-performers like general, masonry, concrete, contractors usually have storage yards; some particularly large including full-time supervision, yard people, and truck drivers. I was told by a Midwest

contractor “*these employees know where everything is, how to handle it, and where to delivery it so we can’t just let them go when work slows*”. For this seasonal contractor work slowed to a crawl every winter and there were nine yard employees, with only three actually needed in the winter. Six were let go during November, maps were made of the yard over the winter, locations were labeled, and GPS was installed in the delivery trucks. Two people were hired the following April, three in May and with improved efficiency, supervision, and a little overtime seven people have handled the yard for the last several years. As mentioned last week, flexible overhead is as much a state of mind as it is a process. Getting people, who are used to doing something in a particular manner, to consider a new method is 90% of the effort. Once understood no construction person has to be shown how to do it. It comes naturally, they understand efficiency, productivity, and it is their company. They know “instinctively” what to do and how to do it. The use of part-time employment and student workers (where permitted) is also an underutilized, economical resource to support the skilled workforce, particularly during peak periods.

When work falls off redundancy in the field is immediate. In a union firm engaging and letting go of field labor is almost routine so it self-corrects. Open shop employees trained at the firm’s expense are harder to part with. Foremen, superintendents, and project managers are another story because we need these highly skilled, loyal employees so planning for market declines is critical. Most foremen and superintendent have come up through the ranks having been trades people before moving up to foremen then superintendent and, to a much lesser extent, to project manager. The element of flexible overhead referred to as “*temporary regression*” is when work slows foremen go back to working with the tools, superintendents go back to being foremen or working with the tools and project managers with trade experience have the same opportunity. I am asked “*what if they refuse*” and my answer is: “*They have announced their lack of loyalty so let them go*”. There is little to be gained negotiating with people whose job you were trying to save.

If work slows for an equipment intensive organization such as generals, concrete or masonry contractors, etc., equipment is idled but the ongoing costs of ownership continues. This element of flexible overhead “*equipment cost controls*” precludes the ownership or long-term leasing of any piece of equipment that does not work 65% of each year (unless highly specialized and not available to rent). Short-term rental-and-return each time it is needed is cheaper than owning equipment not in use 65% of the time (do the math). When you get control of overhead, the need to maintain volume no longer drives the business and enables you go after only risk balanced work within the organization’s core competencies. The most profitable alternative in a downturn.

Next week: US Economic and Construction Market update.

To assure you will continue to receive the free weekly Crisis Message to Contractors, send your email address to tom@schleifer.com. - or questions/comments.

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