BEATING THE BOOM & BUST CYCLE IN THE CONSTRUCTION INDUSTRY

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Been in the construction biz long? If yes, then you have survived both Boom and Bust times. Did you enjoy either? Certainly periods with an abundance of work are preferable to periods of work shortage. However, even the go-go times of a Boom period often exacts a high price on the contractor’s quality of life with long hours, stress and chaos, with less banked results than the available potential gains.

The purpose of this report isn’t to repeat recycled advice such as be sure to save money during the good times, but instead to dig down to a deeper, more granular level. This report will explore how the cycles work so that contractors can chart a better course through them. You can minimize the negative impact of these cycles, maintaining a healthy balance in income and workload throughout each part of the Boom and Bust cycles.

About the Inevitable Boom and Bust Cycles in Construction

The business cycle, often called an economic cycle, is the fluctuation in economic activity that is experienced over a period of time. A business cycle is basically defined in terms of periods of expansion followed by shorter periods of recession. We’ll call them Boom or Bust periods. During the times when the economy or a specific industry is expanding (Boom) we see increases in indicators like heightened competition for workers, increase in available projects and a lift in personal incomes. During recessions (Bust), the economy or specific industry is contracting, as measured by decreases in the above indicators. Presented graphically, a generic economic cycle looks like this:

The Economic Cycle

![Economic Cycle Diagram]
Construction Boom and Bust Cycles are often, but not always, related to the global, national or regional economies. In construction, both cycles tend to trail the national and regional economic cycles by 6 to 18 months. There are also construction cycles based on micro-market economics, changes in technology, interest rates and other reasons.

Construction industry revenues grow more than other industries in the Boom periods and fall harder during the Bust Cycle. Smaller construction firms are less able to downsize to meet a contracting demand, but can expand as fast if not faster than larger firms in response to the Boom cycles. Construction is very heavily impacted by interest rates, which can throw construction Boom and Bust Cycles out of sync with the national or regional economy. For example, even though the national economy was slow in the early 2000s, construction boomed due primarily to easy credit and low interest rates.

What is the Real Impact of Boom and Bust Cycles on Small Contractors?

Look at the Economic Cycle graphic on page 2. Economic cycles are a recurring pattern, repeating the peak, recession, trough, recovery and back to peak cycle over and over again. Therefore, the activity level will always move in relation to the Growth Trend line on the chart. This line is also called the Median Line. The farther away from the Median Line a current cycle is, the more predictable the length of time becomes before returning to the Median Line. Look at the following chart showing the Boom and Bust Cycles starting in 1949. It's not difficult to see that the Median Line across that timespan is about 2.25% Gross Domestic Product expansion.

It is not surprising that the construction Boom and Bust Cycles also move in relation to national Gross Domestic Product growth rate of about 2.5% over this same time period. Ideally a contractor wants business operations to stay as close to the Median Line as possible, rather than chasing the Boom and Bust Cycles. This is not to suggest that the cycles can be ignored, or that Bust times can be as good as the Boom peak. However, taking a more proactive stance in business rather than the more common reactive stance is
the foundation of insulating your business from the negative business aspects created by
the cycles. There are well-proven business strategies for contractors that will mitigate the
impact of the cycles. Surprisingly, these Boom and Bust Cycle mitigation strategies are not
implemented nearly often enough. Methods for doing this are presented in this report.

The Bust Cycle. The period of industry contraction is often misunderstood by contractors.
It is commonly interpreted as a lack of available work. Actually a Bust Cycle in construction
is better characterized as an excess of competition. There is a difference and understanding
that difference allows for the identification of strategies to better manage the Bust cycles.

Consider: In the U.S. in the very worst year of the last 25 years the construction industry
generated (private construction only) nearly twice the total revenue than any of the following
industries have generated in their very best year!

- New car sales
- Computer hardware and software sales
- Consumer electronics sales
- Commercial and general aviation sales
- Gas and oil sales
- All forms of media advertising

From this perspective it becomes clear that there is plenty of revenue even in the worst of
times for a well-run, nimble, clever contractor to prosper in any cycle. Viewing the down
cycles as simply a lack of available work (demand) causes resignation and even paralysis
on the contractor’s part. Realizing it’s really about too much competition (supply) for the
$501,000,000,000 ($501 billion) of revenue that is available in the worst of years gives both
hope and basis for a game plan to do better. A contractor can’t do much to affect demand,
but a contractor can do many things to win even when the industry is in an “over-supply”
state. A contractor that can increase their market share during a Bust Cycle without relying on
price reductions to do so can truly minimize the pain of the down cycle.

It must be recognized that a “follow the herd” approach to the contracting business in a time
of too much supply (competition) will suffer the most. Further, the owners of a follow the herd
strategy in down times will become convinced that they are helpless to change the outcome.
This knowledge must play a key role in shaping a contractors business strategy and/or
business model to achieve superior results in such a cyclical industry.

The Boom Cycle. Unlike the Bust Cycles, the periods of industry expansion aren’t
misunderstood by contractors however, contractors commonly misplay their hand, sometimes
badly, during these times. The high level of available business combined with the memory of
the sting of the previous Bust Cycle often causes contractors to let slip many of their proven
business processes and controls. Sloppiness in management and financial controls become
prevalent and profit margin drops. These margin drops in Boom times rob the contractor of
the fattest part of the financial gains available in Boom Cycles. Along with not securing the
potential financial gains of the busy times, personal lifestyles are sacrificed to “make hay
while the sun shines.”

There is a better way. Both cycles can be managed for much better outcomes but the
majority of the work needed to manage them must take place in the Boom Cycles—when contractors often feel they are too busy for any foundational repairs. However, there is a solution and that solution spans all segments of both cycles and results in the highest total cumulative profit for the contractor and a more pleasant personal lifestyle. At Aspire we teach it and implement it with our clients every day.

How to Beat the Boom and Bust Cycles

1. Business Model

The word “Model” may suggest a complex process that involves unfamiliar concepts and difficult mathematical formulas. Actually business model optimization is much more straightforward and accessible. Every business has a business model, even if that owner has never thought once about it. The important question is whether they have a business model that can achieve their goals. The right business model will connect to the business owner’s dreams if the model is executed reasonably well.

A business model at its most basic is a blueprint describing how the pieces of the contractor’s business fit together to achieve a defined objective. One general contractor may provide services through insurance companies to restore commercial buildings damaged by smoke, fire or flood. Another may specialize in high-end kitchen and bath remodels while another may try to find their niche with low prices. One GC may have their own team for design, framing, drywall and painting while another may use sub-contractors almost entirely. All are contractors in the construction industry but each has a different business model. Ultimately the business model answers these questions: Who is your customer? What does the customer value that you are prepared to deliver? How do you differentiate your business from the competition? How do you find and retain the right customers and how do you deliver that value with profit left over for you?

A business model has two primary parts. One part is the numbers—will the business be able to charge more than the project costs and overhead. Another part is the story. A business model is the story of how your business should work. The business owner will prosper who pays attention to that story and continues to make it a better story, rather than just dealing with the opportunities and processes thrown at them. Every successful organization has a sound business model as its foundation, even if the model was created by accident.

Business models designed pro-actively with knowledge and forethought have embedded within them the power to minimize the negative impact of the Bust Cycles as well as to get the maximum benefit from the Boom Cycles while maintaining a healthy cashflow and workload. Business models that evolve reactively, without clear direction from management, will not only absorb the full impact of the cycles but actually magnify the negative impact.

2. Business Strategy

A business model isn’t a strategy but a blueprint. From this blueprint management
must create an effective operating strategy for achieving its goals. Fundamental to all contracting business strategies is an effective Competitive Strategy, also called Differentiation. A competitive strategy explains how a contractor does better than the average. Just generating the industry average bottom line (1.4 to 2.4% depending on type of contractor) is not a win—you work too hard and your work is too important for a near break-even outcome. Doing better means doing different, setting your business apart. When contractors only offer the same services at similar prices then no contractors will prosper. Contractors that achieve superior performance do so because they are unique. By design they do things that separate them from their competition. Ultimately this is what business strategy is—how are you going to do better by being different.

When a contractor fails to differentiate from his competitors, that contractor can do very little to soften the negative impact of the Boom and Bust Cycles.

3. Stable Marketing Strategy

Marketing strategy is commonly interpreted by contractors as lead generation. It’s true that lead generation is an important part of a solid marketing strategy, however it is not the beginning or the end of the marketing process. Simply driving leads and referrals isn’t a marketing strategy. A powerful marketing strategy will also include competitive positioning, a clear value proposition, differentiation, story and methods for delivery of the marketing strategy. Marketing is closely linked with Sales but it’s more useful to separate them into business components when planning and executing the plan.

A solid marketing plan takes the lead role in helping you manage Boom and Bust Cycles. Because marketing is so often thought of as lead generation only by contractors, attention to marketing tends to be emphasized during times slow times and neglected during the busy times. This pattern actually exaggerates the negative impacts in both the up (too many hours and stress) and down (cash flow, profit and stress) business cycles.

Previously in this paper we talked about the Median Line that tracks the balance point between the Boom and Bust Cycles. Any good marketing plan will try to stay as close to the median line as possible and not chase the ups and downs. The right marketing plan will be implemented continually throughout the cycles.

Marketing is most critical during the Boom periods. In a Boom period there is greater demand than there is supply. Contractors are coming off a down period and the appearance of lots of available work creates a gold rush-like atmosphere. Contractors may have debt or extremely stressed cash flow from the previous Bust Cycle and grab all of the work they can do (and more work than they can do well or profitably). Good business practices are lost in the gold rush and margins (the amount of your revenue you keep after paying the costs incurred by winning and doing the job) shrink. More revenue is generated but significant profit potential is lost. Profit, which if retained with a good market plan and margin management, could have really helped the contractor move through the next Bust period.
The inevitable down cycle appears suddenly (in actuality it does not appear suddenly but seems so to an unprepared contractor) and catches the contractor without reserves, a broken lead generation process, little or no backlog and sloppy systems. The result is the contractor takes the full brunt of the Bust construction cycle. And so it goes.

A good marketing strategy must be balanced and consistent. Dials and levers can be fiddled with within a consistently applied marketing strategy to increase or decrease the lead generation part along the way. However, the company’s value proposition (what you do differently than your competitors), your market positioning (how you are perceived by potential clients), the number of touches of previous clients and level of effort of tapping into new ones needs to remain fairly constant.

A well-balanced, effective marketing plan will bridge the Boom and Bust Cycles—reducing the negative impact of each. Thinking about marketing only when you get slow is guaranteed to make your business a victim of these cycles, rather than capitalizing on them.

4. Know Your Sales Cycle

How long is your sales cycle? How much time does it take to generate a lead and eventually turn that into cash flow? Every contractor will be a bit different but if you figure this out by measurement you just may find that it will be more than twice as long as you felt that it was. Without knowing your sales cycle it is very difficult, if not impossible, to balance your workload, staffing needs and cash flow. Knowing your sales cycle allows the smart contractor to make strategic moves through the various parts of the Boom and Bust cycle.

5. Get Nimble, Stay Nimble!

Small contractors (under $15M per year in revenues) have a wonderful advantage against the big guys—and that is being quick on your feet.

One of the biggest things you can do to be quick on your feet is to consider using more subs and fewer in-house employees. That is not necessarily a recommendation—there are other factors and personal preferences to be considered. However, it is a fact that you can scale your business up or down much more quickly if you have fewer in-house people. Again, other factors can tip the scales in the other direction but if mitigating the pain generated by the Boom and Bust Cycles is a high priority to you then you should give this much thought.

Job mix is another important factor. Do you do remodels, new homes, a spec home here and there and commercial work when it falls in your lap? Do you try to address both the high-end market and the price shopper market? Do you just take whatever you can get during the Bust Cycles? We hope not; a scattershot, uncontrolled job mix usually generates poor bottom-line results. However, from a nimbleness standpoint the “we do it all” approach does allow a contractor to pivot more quickly as the economy closes some opportunities and opens others.

The key here is to professionally approach the design of your business model. All
business models involve trade-offs. Your model needs to reflect your goals and the realities of the marketplace. Business model design should involve the counsel of professionals, not only those that have already bought into the way you have been doing it.

You are a custom home builder and interest rates go through the roof. What do you do? Some custom home builders may start doing remodel and other work. Most contractors sharpen the pencil to win jobs, thereby reducing their margins and therefore their profit and cash flow too. However, the contractor isn’t as practiced at these other profit centers, usually resulting in thin profits and lots of stress.

While this last recession was a bit of an outlier in depth (we hope) every Bust Cycle tears down much of the contractor’s infrastructure, business processes and momentum. The cost of this damage carries deep into the Boom Cycle, limiting results and increasing hours worked. A contractor who does, for example, custom homes, remodel and maintenance and service is far better ready for priority shifting than the new home-only builder that is forced into remodel work to stay alive. Again, that doesn’t mean that doing lots of types of work is the best model for you. Business models involve trade-offs and your trade-offs are unique to you.

Without diversification a contractor can find other business model changes to better position them to absorb the ups and downs with a bit more grace and control. Specialization is one of those ways. Perhaps becoming a high-end kitchen and bath remodeling specialist, or certified green builder or healthy home specialist would allow you better margins in good times and some protection in the Bust Cycles. Maybe a unique and effective marketing strategy might provide a firewall between you and the Boom and Bust Cycles.

A smart contractor will also look for what are called “anti-cyclical” business strategies. For example, a crash in new home building will increase activity in the remodel and rental market. Baby boomers are affecting the retirement home market. Income tax policy can affect the vacation home market.

There are many other tips and strategies to better handle the Boom and Bust Cycles. There is the reliable old recycled advice as well; save money in the good times, don’t carry debt and never carry debt into a down cycle and, of course, remember to floss.

6. Learn to Read the Tea Leaves

If you could precisely predict the Boom and Bust Cycle timing for the construction industry you would be very rich—and you’d also have learned how to do actual magic. Predicting our up and down cycles long before they happen isn’t going to happen. However, predicting these cycles can be more like predicting the weather three days out, not a month out. A month? The only weather forecasting a month out is based on historical averages. Three or four days out? Still a risky business but the likely outcome range can be narrowed by understanding meteorology and sorting out a somewhat bewildering array of variables currently in action around the globe. Putting some boundaries around the time of the construction cycle changes
can be quite useful in helping a contractor make key decisions.

Predicting economic cycles is a big business, particularly to the financial markets. However, predicting economic cycles is serous work. It takes years of study, heavy-duty mathematics, computers and maybe the phone number of a fortune teller. Methods for forecasting construction Boom and Bust Cycles include Time-Critical Decision Modeling, Box-Jenkins Methodology, Causal Modeling and other methods generally out of reach to the contractor.

**What can a Contractor do?**

Remember that the cycle for your business will always go through its predictable cycles and therefore, must always pass through the Median Line in order to change cycles. The farther away from the median line a cycle is, the sooner it is likely to turn upward or downward. A little browsing and you can find the various construction cycles over time. The chart on page 3 of this report shows economic cycles since 1949.

Happily, the average length of the expansion cycles tend to be longer than the contraction cycles (58 months vs. 11 months). The sum of these two averages says that the average time between cycle peaks or troughs is 69 months. There have been 10 economic cycles since 1945. As they say in the investment business, previous results may not be indicative of future performance. Absolutely true, but you can narrow the possible outcomes to make better business decisions.

If you consider these averages and remember that construction cycles trail the national or regional economic trend by 12 to 18 months you have a start on making better timed business model and strategy decisions. Interest rates can impact the construction industry more powerfully than the national or regional economy.

**The Most Important Thing You Can Do Right Now to Reduce Workload and Stress During This Boom Period.**

A very costly mistake made by many contractors is to misunderstand how their profit is actually generated. This is an important topic anytime but it becomes critical when in either the peak of a Boom or the trough of a Bust period.

This subject is so critical to a contractor’s success that The Aspire Institute offers workshops around the country to teach this topic to contractors.

*Here it is: Contractor revenues do not track profits.* Focusing on revenue or number of projects completed can be a very costly path to follow. If it were about the size of the revenue stream then we would expect that The Truland Group, John S. Clark, Collavino Construction and The Lamar Construction would all be prospering and you would be gone. These companies are just a fraction of the $100 million-plus companies that have gone bust. You are still in business and they are gone; suggesting that generating revenue isn’t where the win is. The win is in keeping the right percentage of your revenue (Average Gross Margin) after paying all the job costs. That is how profit is generated.
For example; let’s say you are a $2.5 million per year operation carrying an Average Gross Operating Margin (AGM) of 15% and you are at a strategic fork in the road. One road would be a plan to drive revenues that would make you a $3M contractor, but the required aggressive pricing and additional field costs of that plan would erode your AGM by 3 points leaving you at 12%. The other road would focus on raising your AGM but would actually reduce your revenue by about 10% to $2.2M by doing 15% fewer projects. However, this margin-focused road would position you to increase your AGM to 24%.

In the revenue focused growth plan your Gross Profit Dollars (GPD) would increase from $300K per year to $360K per year. A nice pickup of $60K per year to your bottom line but you had to win and handle more projects to get it done. The Gross Margin-driven plan would increase your Gross Profit Dollars to $528K, representing a real bottom line lift of $228,000 to go along with the reduction in projects, chaos and workload. Which road makes more sense for you?

A management focus on Gross Profit Dollars rather than revenue is one of the most basic and important management concepts for a contractor. During Bust and Boom Cycles it becomes absolutely critical to understand and practice this fundamental business concept. Higher margins pave the way to have a personal life and getting all of the potential bottom-line potential during Boom times. Higher margins and disciplined margin management allows you to keep your cash flow reasonably stable, keep your team together and sleep a bit better during a Bust period.

**Summary**

We hope you found this information helpful. Learning a bit more about business and having the courage to take a proactive, rather than reactive, stance can give you back your life and both optimize and stabilize your cash flow. You don’t have to take only what is dished out in this industry. You can do better.

If we confused you, or if you want to learn more, we would like to invite you to one of our educational events that are held continuously around the country. We make them as affordable as we can and it just might change your life.

To learn more about these events and see when one is going to be held near you visit [www.theaspireinstitute.com](http://www.theaspireinstitute.com), email us at [info@theaspireinstitute.com](mailto:info@theaspireinstitute.com) or call 888.252.8998.