No one Likes Recession - Some are going to Hate Recovery (Back to Table of Contents)

A study of the economic dynamics of prior construction market rebounds indicates the recoveries are a financial struggle for many contractors. The primary reason is that growth eats cash and many firms strain financially during downturns to the extent they have difficulty financing the growth of a recovery. The research is conclusive that during much of the recovery margins remain low because aggressive bidding continues until the appetite of construction organizations is satisfied. The research also confirms that the failure rate of construction enterprises is much worse during recovery than during the downturn. My study indicates that contractors need to understand how to approach recovery. I am afraid if some did not like recession they are going to hate recovery.

The length and depth of a market slowdown impacts aggressive pricing, changes in owner attitudes, and declining margins. Construction organizations need to manage cash flow judiciously during recovery to remain financially viable and credit worthy. Contractors need to develop effective strategies to deal with the significant cash flow demands of growth which requires the discipline to resist engaging in the “feeding frenzy” during early recovery. Comprehensive strategies are necessary to manage risk and avoid losses, deplete capital or diminish equity weakening the ability to share in recovery. Bonding capacity may also be affected creating barriers to fully participating in recovery.

Compounding the problem is the fact that in the three major construction market downturns in the last 70 years, aggressive bidding persisted until the market returned to prior size which, in the recent case, is $1.1 trillion. Continuing aggressive bidding compresses margins when they are needed most. Contrast this with the healthy growth market of 2005 through 2008 where the industry was able to finance the growth with profits. Absent the profit potential, the recovery growth will require outside financing which will be problematic for financially weakened firms. Add the uncertainty that the banking industry is ready to re-engage in construction lending, for some companies, it becomes the “perfect storm”.

Prospering in cyclical markets and surviving both a recession and recovery in the construction industry starts with recognizing what is happening in the marketplace. The results are totally predictable and have occurred without fail in every industry cycle for the last 70 years. When there are fewer projects in any market, competition intensifies and prices and profit potential diminish. In a shrinking market the ideal would be for each contractor to accept proportionately less work so that market share of each business is maintained. However, there is a tendency in our industry to resist any reduction in sales, often strenuously, and to fight vigorously for the fewer available projects, driving down prices for everyone. The tendency persists, perhaps even stronger, through initial and intermediate stages of recovery when every project looks like the last project we may see. Trying to maintain volume in a declining market is, in effect, an attempt to increase market share and any increase in market share is universally “bought” at a cost. Trying to be the first business to return to prior size creates the same effect, limiting profit potential and magnifying risk in an already risky business.

This exposure is compounded by the fact that in each stage of recovery, particularly after a sustained downturn, inflation is common; caused by labor shortages and material cost escalation

and shortages. Some laid-off construction tradespeople and managers who have vacated the industry do not return or return only after confidence in a sustained recovery. Material manufactures and suppliers have suffered the same financial difficulties as contractors, forced to cut back capacity and unable to raise prices. Regaining the capacity requires investment and takes time causing material shortages that lead to rapid price increases.

If history repeats itself, contractors attempting to make up for lost ground in a downturn will load up on cheap work increasing their risk in already difficult circumstances. We cannot control the market, but we can control our response to it.