



THOMAS C. SCHLEIFER, Ph.D. • KENNETH T. SULLIVAN, Ph.D.
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MANAGING THE Profitable Construction Business

THE CONTRACTOR'S GUIDE TO
SUCCESS AND SURVIVAL STRATEGIES



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MANAGING THE PROFITABLE CONSTRUCTION BUSINESS

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and Survival Strategies

Thomas C. Schleifer, Ph.D.
Kenneth T. Sullivan, Ph.D.
John M. Murdough, CPA



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FOREWORD

Construction professionals need this book. The construction industry contributes to a significant part of our nation's gross domestic product every year. The industry comes very close to the pure free market system our forefathers envisioned with little barrier to entry but also little barrier to failure. In good times contractors do not have to be the best strategic managers, but this is a cyclical business and in difficult times they have to be strategic, decisive, and unafraid to make tough decisions. Until this text, there has been limited published guidance available on effective strategies and processes on how to prosper in the highly risky construction business.

In this work, Tom Schleifer has given away his "secrets" and has gathered two coauthors who were willing to do the same. I have known Tom Schleifer for many years and over those years I have come to respect his vision of the industry. He has the combination of hands-on experience as a successful contractor and the experience of a long career as a construction consultant, researcher, and educator. In his work as a management consultant to the surety industry, Tom has probably seen and assisted more financially distressed construction businesses than anyone in the industry. This experience gives him a unique perspective on how to manage a construction business successfully. He wrote the seminal book *Construction Contractors' Survival Guide*, which has been acclaimed by thousands of contractors and is a reliable guide to industry credit grantors.

Tom is commonly referred to as a "turn around" expert because of the number of construction companies he has rescued from financial distress. He applied his knowledge and experience as a consultant to the surety industry and later became a sought-after private consultant. Tom is also a sought-after lecturer for industry organizations around the country and in his current role as a research professor at the Del E. Webb School of Construction at Arizona State University, he has been a driving force in developing research and models of the industry that are both revealing and realistic.

Tom is known for telling it like it is. Anyone who wants a crisp clear view of the construction industry and the strategies required for success should definitely read this work.

Terry Lukow
Retired CEO Bond and Financial Products, Travelers

PREFACE

The construction industry continues to become more sophisticated, has fully embraced and implemented computerization, and continues to employ new technologies, particularly in long- and short-range communication equipment. The industry has also moved closer to becoming a commodity, which is the primary reason profit margins are low compared with the historic norms of 10 and 20 years ago. Lower margins increase risk by allowing less room for errors. Profit enhancement over the next decade will result primarily from productivity improvements.

Management decisions alone determine whether an organization will succeed or fail in the construction business. Many construction professionals believe that they lose money or fail because of weather conditions, labor problems, inflation, unexpected rises in interest rates, the high costs of equipment, a tightening or shrinking of the market, or simply bad luck. Actually, none of these are primary reasons for contractor failure. They may contribute to failure once a bad management decision is made, but they are not the basic cause of failure. Failure to obtain a profit or even survive is often attributed to factors or conditions over which management has no control. This is not the case.

Surviving or even thriving in the industry does not imply management can drop their guard. Growth, expansion, and basic ongoing operations usually involve change. And change has risks associated with it, which can make or break an organization.

Unfortunately, past success is not an indicator of future success. When a company expands in size, takes on larger projects, or goes after projects of different kinds or in different territories, it requires management decisions to reduce the risks inherent in such change. An enterprise may be doing fairly well, or even very well; however, the stress to an organization of growth or change can cause a weak component to become a fatal component. Change itself has to be managed to minimize risk.

One problem is that construction professionals don't talk to each other or share information freely enough to create and share a body of knowledge on how to manage a construction business. They meet, converse, socialize, make jokes, and tell stories about each other, friends in the trade, and competitors, but they don't tell each other about how they run their businesses. They don't talk about

mistakes that cost profits, postpone deadlines, or worst, jeopardize entire companies. There is an unspoken code among construction professionals, but virtually everyone knows it or learns it soon enough: Learn the essence of the industry, acquire the essential information not taught in classes, and secure knowledge of the business on your own through personal experience. Once gained, that information is yours. You've paid for it. You've earned it. It's your personal property. Let others earn it and learn it the same way. Because of this attitude, the industry reinvents the wheel every day.

There are some very good reasons for the existence of the code, but most are outdated. Construction is a very horizontal industry. If you include those people involved in ancillary jobs or in the manufacturing and transporting of building materials, there are more people involved in producing the built environment in this country than in any other industry. It's a huge industry with over a million individual businesses. The turnover rate as companies go out of business and start-ups replace them is phenomenal. Construction is, undoubtedly, the most highly competitive and high-risk industry in the United States. Consequently, if construction professionals can survive a mistake, correct it, and learn from it, they know something their competitors might not know. This information gives them a competitive edge they are not likely to give away.

To put this in perspective, think of the other industries that compare to construction in terms of their contribution to the gross national product: the automobile, steel, oil, and aircraft industries. All of them have extensive training programs to train their personnel from entry to top-management levels. And these training programs are ongoing and under continual review and revision. These industries have also developed a system of checks and balances on their decisions and strategies; they have boards of directors to ensure accountability and monitor managerial decisions and techniques. In contrast, nine times out of ten the construction professional has learned how to run a construction enterprise by watching, by working various jobs, and by working with someone who has been successful in the past. There is a lot of truth in the old construction story that all you need to start a construction enterprise is a pickup truck, a hard hat, a box of tools, a cast-iron stomach, a forgiving wife, and a bad temper. Many have started with less.

There isn't one way to run a construction enterprise, but there are only a few ways to run one successfully. People in the industry seem to assume that there is no single method to be taught because there are as many ways to run a construction enterprise as there are construction enterprises. The tragedy to the industry is that this is a false assumption. While each business develops its own style, there are only a few ways to run, structure, operate, and manage a construction business successfully and control business risks. Some like to believe that sheer energy, drive, ambition, know-how, and guts will get them through this high-risk industry, and it will for a while. However, there comes a time when that energy and drive have to be organized, given direction, planned, and held to objectives. Without appropriate structure, proper organization, and risk recognition and management, success is elusive.

Put simplistically, a construction enterprise has only three primary functions: getting the work, doing the work, and accounting for the work—marketing, operation, and administration. These three functions are separate and distinct from each other, and to be dealt with effectively they should be analyzed separately. Business and technical activities should be broken down into these functions, and time and energies budgeted to manage the functions appropriately. It is imperative that one person must have direct personal responsibility for each of these three functions. This can mean three different people or two or one. It is not unusual for a small enterprise to have one person handling the getting and accounting for the work while another handles operations. Neither is it unusual for one person to handle all three functions. But as a business grows, the functions remain distinct. The personal responsibility must be clearly recognized. One role may appear more important and significant to the operation of the company. But that is mere appearance and neglecting any of these functions is courting failure. They are each essential to success.

Individuals who accept responsibility for one or more of the three primary functional areas of management described previously are key to the organization whether or not they own a piece of the company. It is critical to success that the individuals believe they are ultimately responsible for the success of their functional areas of the business and accept responsibility personally, not as a functionary or an executive, but as a principal in the organization.

There are reasons for the code, but unfortunately it has some very negative spin-offs. Without cross-fertilization, sharing of essential information, and the collection of a body of knowledge available to the industry as a whole, there is a significant time lag between improvements and modernization within the industry and when that information becomes widely known. Better ways to operate and organize construction enterprises and improve management and production are usually closely guarded secrets for those who discover them. There are methods that can be learned and must be employed to control the risks in this extremely high-risk industry, to allow participants to take informed risks, and to allow managers to learn from the mistakes of others as well as their own. Unfortunately, major business strategy mistakes in the construction industry are often fatal to the enterprise, and until now, no one has collected sufficient data on the subject to provide the hard facts.

This book identifies the common elements of contractor failure and how to avoid them, and presents strategies for construction organizations' business success. This book, a product of the authors' decades of experience in the industry and the collection of a wealth of information on the causes of construction business failure, categorizes the causes and creates a learning tool. Hundreds of actual examples have been annualized to isolate the common causes or elements of failure. One or more of these elements has appeared in every business failure studied. The discovery of what *not* to do leads to researching, developing, and cataloging the elements of successful construction enterprises: what to do.

We begin with organizational principles because many managers believe that quality construction and a few breaks should guarantee business success. They

don't. Identifying and understanding the elements of past failures will provide the reader with the means to achieve future success similar to the way generals review past battles and the way medical researchers study illnesses to find preventions and cures. If any good at all can be said to come out of the tremendous number of industry failures over the years, it would be to pass along the lessons learned from their mistakes. This book is dedicated to the fine construction professionals who didn't make it, and the information is offered in the name of those good men and women.

Thomas C. Schleifer, Ph.D.,
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Scottsdale, Arizona
March 2014

ACKNOWLEDGMENTS

The contributions brought to this book by the coauthors, Kenneth T. Sullivan, MBA, Ph.D., and John M. Murdough, CPA, MBA, are new knowledge not understood or recognized until now. Their years of practical experience and hands-on research into how the industry functions will benefit construction professionals and students for years to come. One of the great pleasures of working on this project was numerous stimulating interactions and discussions from which I was able to learn and expand my understanding of many issues impacting the industry.

The tireless work and contribution of Arizona State University Ph.D. candidates Anthony Perrenoud, Brian Lines, and Kristen Hurtado added significantly to the quality and accuracy of this book and cannot be underestimated.

HOW TO USE THIS BOOK

PART 1

After an overview of the industry and a general presentation of the common elements of construction business failure, subsequent chapters address the top five elements. The chapters will define the elements of failure clearly, give real examples, and discuss ways to minimize the risks involved. The recognition of these elements is a tremendous asset. After the elements of failure have been discussed together and separately, succeeding chapters demonstrate how to take these don'ts and use them to develop a positive and competent management attitude and strategy.

PART 2

Chapters 12 to 18 outline proven strategies of success and are an expression of the authors' many years of industry experience and research. Unlike typical management texts this work addresses advanced and proven concepts and methods about how to organize, operate, and succeed in the construction business. It is an executive, CEO, and contractor level how-to manual to understand a complicated and risky industry and be able to navigate and maneuver through it. The authors have developed a profit-centered approach to the high-risk construction business. The second section contains the elements of success: appropriate practices that assist in avoiding and counteracting the elements of failure presented in earlier chapters.

A TEACHING TEXT

Construction schools, colleges and universities can use this book as a teaching text in their construction education programs. To facilitate use as a teaching tool, multiple choice questions are included at the end of each chapter with answers in the back of the book. Also included are critical thinking exercises designed to stimulate group or classroom discussion. There are no answers for these exercises as they are open-ended reasoning tools.

ABOUT THE AUTHORS

Tom Schleifer, Ph.D., joined the construction industry at age 16 and has more than 50 years of contracting and consulting experience. He has Bachelor of Science and Masters of Science degrees in construction management from East Carolina University, and a Ph.D. in construction management from Heriot-Watt University in Edinburgh, Scotland. Dr. Schleifer's experience includes serving as foreman, field superintendent, project manager, and vice president of a construction company that he owned with his brother. From 1976 to 1986 he was the founder and president of the largest international consultancy firm serving the contract surety industry. During this period, he assisted in the resolution or salvage of hundreds of distressed or failed construction firms.

This combination of practical, hands-on experience as a contractor and assisting financially distressed companies has given Dr. Schleifer a unique perspective on the causes of business failure and how to avoid them. Dr. Schleifer, sometimes referred to as a “turn around” expert because of the number of companies that he has rescued from financial distress, advises contractors on organization, structure, and strategic planning while he also writes, lectures, and teaches.

The importance of education in the construction industry is one of Tom Schleifer's favorite themes. He has lectured extensively at universities and professional and trade associations, and authored numerous articles and publications on construction and business management. Dr. Schleifer has been listed in *Who's Who in Finance and Industry*, *Who's Who in America*, and *Who's Who in the World*. He was the 1993 Eminent Scholar of the Del E. Webb School of Construction, Arizona State University.

Publications by Dr. Schleifer include books (*Construction Contractors' Survival Guide*, John Wiley and Sons; *Glossary of Suretyship and Related Terms*, CMA Press), video and audio tapes (*Schleifer's Construction Profit Series*), and a newsletter (*Schleifer's Construction Forecast*).

Kenneth Sullivan, Ph.D., is an associate professor in the School of Sustainable Engineering and the Built Environment at Arizona State University (ASU). Professor Sullivan possesses Bachelor of Science and Master of Science degrees in Civil and Environmental Engineering, an MBA in Real Estate and Urban Economics, and a Ph.D. in Civil and Environmental Engineering, all from the University of Wisconsin—Madison. He grew up in a construction family and has spent his entire life in the industry, with his father working in the

transportation infrastructure and heavy civil sectors of the industry, and eventually running his own company.

Professor Sullivan specializes in performance measurement, risk management, best value contracting, organizational transformation, and accountability systems. His research processes have generated over \$6 million in research funding and have been implemented in hundreds of real-time projects valued at over \$3 billion. In addition to all types of design and construction delivery, he has led project efforts in networking systems, software, campus dining, sports media rights, radio systems, furniture, health insurance, document management, and others.

He has authored over 120 peer reviewed publications and, in addition to teaching several construction management courses at ASU, lectures extensively to industry professionals, universities, and educational seminars across the globe.

John Murdough, CPA, MBA, is a nationally recognized instructor and workshop leader who combines in-depth construction industry experience with a rare gift for teaching. John's course in the business of construction at Arizona State University's Del E. Webb School of Construction and his many seminars are among the most powerful and popular classes available in the construction community. John received the American Subcontractor Association's *Construction Innovator of the Year* award and the *Plus One* award from Arizona State University, recognizing his innovative educational programs.

In John's consulting and accounting practice in Phoenix, Arizona, he is a key element in the success of many contractors of nearly all types and sizes, using his insight and experience in a variety of business and financial areas. He has been involved with the construction industry for more than 35 years, first working for contractors, then serving as a CPA, consultant, teacher, and lecturer for the last 25 years. John founded a construction-specialty accounting and consulting firm in 1989. In addition to financial statement and tax services, John and his associates work with contractors on a wide variety of management and financial issues from start-up through succession planning.

John's additional contributions to the construction industry include serving as an officer and board member for several construction associations and developing and instructing many innovative seminars and courses for contractors. John is one of the developers of the award-winning Leadership Development Forum for Arizona Builders Alliance and is a leading financial instructor for the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA).

John received a Bachelor of Science degree from Pepperdine University and a Master's degree in business administration from Arizona State University. He is a life director at Arizona Builders Alliance.

MANAGING THE PROFITABLE CONSTRUCTION BUSINESS
