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Op-Ed Ghostwriting for Client's CEO

By Bob Hebeisen, May 2024

About the project: I researched and wrote this thought-leadership opinion piece on behalf of the CEO of my client and placed it in his favorite trade publication.

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Waiting for the Boom: Embattled Construction Companies Need Nuanced Capital Strategies

By Jim Case
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To the casual observer, it must seem like high times for the global construction industry. Massive federal, state and local government funding has been committed to housing and infrastructure stimulus programs, including the $1.2 trillion U.S. Infrastructure Investment and Jobs Act (IIJA) signed in November 2021. The Investing in Canada Plan, launched in 2016, is a 12-year program that committed over $180 billion CAD (over $131 billion USD) to initiatives like public transit and energy systems. The 2024 UK National Infrastructure and Construction Pipeline (NICP) policy earmarks over £700 billion ($889.6 billion) during the next 10 years to fund construction and infrastructure projects.

These programs, and many more like them, should translate to record growth for the construction sector. But, the reality is, the industry is embattled. Always among the most vulnerable sectors, the construction sector has seen more than its share of business failures in recent years. Where's the disconnect? Ironically, the less-than-flawless rollout of these stimulus programs may result in insolvency for many construction companies.

Brutal Times

Small- and mid-size construction companies have a high mortality rate. According to the U.S. Bureau of Labor Statistics, almost 40% go out of business within their first five years, and nearly 55% succumb within ten years. In Canada, the picture isn't any rosier. BIA insolvencies for the 12-month period ending July 31, 2023 increased by 37.8% compared to the previous year, according to data compiled by Innovation Science and Economic Development Canada. In the UK, insolvencies have also increased year over year, and construction insolvencies have outnumbered any other sector for three years in a row.

Cashflow is the Biggest Challenge

Construction companies are wrestling with the same significant challenges faced by many businesses. Materials expenses, driven sky-high during the COVID supply chain crisis, have not recovered fully. Inflation has driven up costs across the board. The high cost of fuel also has a disproportionate impact on this industry, which is reliant on petroleum-burning heavy equipment. A skilled labor shortage has led to high costs.

These businesses are, by nature, capital-intensive and cashflow-challenged. They rely on the purchase and maintenance of heavy equipment to bid for and complete jobs, and must prepurchase materials and preassemble staff. This requires walking a tightrope between receivables, payables and capital costs. Scaling up for projects is necessary, and solvency typically hangs in the balance depending on whether the company gets the timing just right.

Unfortunately, fast and predictable timing is not the strong suit of government-funded projects. For example, the U.S. IIJA, signed in November 2021, has so far seen ground broken on only a few large projects in Iowa, Massachusetts and Tennessee. Most of the funding is tied up in projects that are only now in the design and procurement phase. Though the funding is ample, the federal program does not include subsidizing the municipalities that must approve, administer and oversee the swelling volume of work. For local governments, the capacity issues are glaring.

Hurry Up & Wait

Delays kill construction companies. The danger is exemplified by the case of J.A.R. Concrete, a 65-year-old construction company in Texas driven into bankruptcy in 2023 by the delay and administration complexities of a federally funded highway project. Company management believes the project was delayed due to the government's failure to secure timely right-of-way clearances and take other measures to make the job site accessible, making it impossible for J.A.R. employees to perform their work. The Camino Real Regional Mobility Authority (CRRMA), the local agency charged with project oversight, claims J.A.R. Concrete defaulted on its performance bond and failed to properly account for its costs. "When you have a federally funded program, you have a lot more requirements that are necessary before issuing a payment to a contractor," Raymond Telles, executive director of the CRRMA, said. "In order to pay, they have to show you they've paid subs and suppliers for the prior month."

After six months of dispute and delayed payment, the company was forced to file for bankruptcy protection. "You're thinking you're gonna generate $22 million over 18 months and you do half of that amount because you don't have the working area available to you; it was a tremendous impact," Jose Rosales, Jr., owner and CEO of J.A.R. Concrete, said.

Similar stories flow in from across the globe. In March 2023, the UK government announced a two-year delay to HS2, a high-speed railway line that will connect London to other large UK cities, citing inflationary pressure and increased project costs. Five months later, a large HS2 contractor, Buckingham Group, went into insolvency administration.

It is shocking how fragile the balance sheet is for construction companies, and how quickly a boom can transform into a deathtrap.

Capital Strategy is Critical

It has never been more important for construction companies to have a solid and nuanced capital strategy to ensure cashflow stability. That extends across multiple facets of the business, including the timely collection of receivables, and for financing equipment purchase and maintenance through the availability of external capital from banks, alternative lenders and private equity.

Today's economic climate poses a challenge for external capital infusions. Bank rates have doubled over the past two years, and banks have made the approval process for loans lengthier and more stringent. If a construction company is in need of fast capital, a bank loan might not cut it simply because the approvals can take too long. Also, many bank loans in this tight capital environment include unappealing covenants that require the borrower to provide regular detailed financial reporting during the repayment phase to maintain good standing.

Other sources of quick liquidity should be actively considered. Asset-based term loans and bridge loans from alternative lenders can be faster and easier to secure because most construction companies own capital collateral like heavy equipment and real estate. Private equity vehicles, including structured equity and NAV loans, should also be explored. Construction executives have no choice but to expand their horizons and evaluate the full range of liquidity options available to keep their businesses safe and poised for growth in this turbulent environment.

Conclusion

The construction sector is poised for sizable growth in the wake of the overwhelming number of publicly-funded infrastructure projects in the pipeline. However, it is not a quick fix for a traditionally financially-strapped industry. Construction companies must strike a delicate balance between scaling up in preparation of bids and projects, while also maintaining rigorous cashflow discipline. A nuanced capital strategy is required to keep receivables, payables and capital investment in balance and to ultimately reap the rewards of the boom promised by government infrastructure programs.

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