



The Big Transition: Ownership Transfer and Management Succession

By Robert Murray

Much has been written about the aging baby-boom segment of the population.

Surprisingly, despite well-documented statistics on the aging workforce, preliminary results of FMI's 2017 ownership transfer and management succession for your business (OTMS) industry research¹ indicate that only 22% of contractors have a formal plan for transitioning themselves out of their businesses.

This situation, combined with the importance of management quality, makes succession planning critical to the future success of a construction business. During such transitions it is vital to have the surety provider's support and confidence in the contractor's financial strength, technical execution capabilities, and management quality and character. While it may come as a surprise to some financial purists, quality of management is one of the most important factors when determining the appropriate level of surety support to a contractor.

Financial Perspective

FMI's preliminary research on OTMS² also shows that 82% of contractors would prefer to transfer or sell ownership of their companies to employees and/or family upon exiting their businesses. In these circumstances, several alternatives exist for supporting the ownership transfer.

One of the cleanest yet least achievable approaches would be to treat the related party (or parties) as an external third party and to then sell ownership interest to that same third party, leaving the financial position of the underlying going concern unaffected by the transaction. The usual obstacle here, of course, is the lack of external funds to support the transaction. For this reason, related party transfers are usually facilitated using other methods.

¹ Preliminary results of FMI's 2017 OTMS study. These are based on responses from FMI's NRCI and CIRT surveys for Q1. Final statistics will be published in the second quarter of 2017.

² Ibid

More common related party scenarios include:

- Traditional external financing to support the company's buyout.
- Injection of capital for a finite period by an alternative financing method such as private equity.
- Ownership transfer through an existing or new Employee Stock Ownership Trust.

Given the legal and tax implications of each option, the relative merits are best addressed by transaction specialists. Suffice it to say, there is a potential for significant impact on the capitalization, liquidity and cash flow of the underlying organization for which ownership is being transferred.

Critical to the ongoing success of a construction company, surety support could potentially be affected by the financial impact of the ownership transfer. To determine an appropriate level of support for a contractor, the surety market uses key factors like capitalization and liquidity relative to the existing and expected work program. The increased debt associated with financing the purchase transaction can often be reasonably serviced by the company's ongoing cash flow. The extra debt burden can add an element of risk to the new organization through reduced cash and working capital available to support ongoing work programs.

In many cases, surety capacity is supported not only by the company's financial resources but also by the personal indemnification of the primary stakeholder(s). The absence or reduction of continued additional support is a factor that could potentially impact the surety's level and form of support.

With that said, many insightful sureties have moved away from a purely formulaic approach to determining support. Accordingly, one should not conclude that an ownership transfer will create a crisis of confidence for the surety provider, but should recognize the value of early, frequent and ongoing communication with the surety as a transaction is being considered.

Leadership Transition

As noted earlier, the financial aspects of a transaction are not the only factors determining surety support of an ownership transition. Equally important, if not more so, is confirmation that the new leadership team has the capabilities and a mindset that is consistent with the previous, successful management team.

A surety's assessment of management capabilities is more art than science, as nearly all sureties recognize that the contractor, rather than the surety underwriter, is the true expert in the construction business. As a result, the surety's assessment is based primarily on overall comfort with the management team's attitude towards financial and operational risk; a realistic attitude towards technical capabilities; and consistent transparency and responsible engagement with owners, subcontractors and service providers. Of course, a track record of successful project execution is the foundation of the management assessment.

Because we provide surety support to many leading construction companies nationwide, we observe consistent key practices that are implemented by many best-in-class customers. Such practices are used to assess and confirm the skills and competencies of contractors' future leadership teams while also preparing future leaders for larger roles, often as part of an ownership or leadership transition.

Here are some of the most common key practices we see:

- **Full commitment to succession planning** – Top companies of all sizes view succession planning as part of their core responsibilities rather than as periodic events. Once top candidates for future leadership roles are identified, the leading contractors spend considerable time developing the capabilities of their high-potential candidates.

- **Ongoing evaluation** – Rather than identifying candidates for a “just in case” checklist, top organizations assess potential and performance on a continual basis when evaluating the readiness of leadership candidates. Further, rather than relying on performance in an employee’s current role, additional “bolt-on” responsibilities are given to stretch a future leadership candidate and determine his or her ability to operate at the next level. In this regard, a safety net is usually provided in order to limit the tuition cost of the education!
- **Transparency** – The pros and cons of transparency with succession plans are often debated. Full transparency can lead to the unintended consequence of resentment from less successful leaders, while limited transparency can result in mistrust within the organization. While there are merits to each argument, our observation is that top contractors tend to have a high level of transparency with leadership succession plans within their organizations. In addition to the internal transparency, the top companies also share their plans early and regularly with their service providers to ensure support for future changes.
- **Planning with no immediate event on the horizon** – Leading companies have made succession planning and leadership development an essential part of their core business activities. This approach results in an “always ready” environment that can make future planned or unplanned succession events less daunting and risky when the time comes.
- **Depth of planning** – When speaking of succession, we often hear people refer to the top jobs within an organization. Leading contractors go beyond senior management jobs when looking at their succession plans and then commit to an ongoing plan to identify and develop talent for positions that are well below the executive level. Over time, these companies have found that the process ultimately results in an extremely strong commitment to the organization’s success, as staff members feel they are part of a well-developed and strategically aligned plan for future growth and continuity.
- **Attracting and retaining talent** – Along with providing clear benefits in preparation for eventual management or ownership transitions, embedding succession planning into a contractor’s culture can help attract and retain staff in today’s highly competitive labor market. An absolute priority for attracting new talent is an environment of frequent feedback and well-developed career plans. A strong succession-planning culture facilitates the environment demanded by the new workers entering the workforce and the future leadership pool.

Reach Out and Be Proactive

Like many industries, construction faces the challenge of attracting new talent in order to ensure a sufficient and qualified workforce in both the C-suite and in the field. With this trend, the issue of succession at all levels should continue to take on a greater level of importance for the successful contractor. Consistent surety capacity for the construction company is vital to the success of construction companies throughout the succession planning process. Contractors should actively engage with their surety provider to help assure that capacity will be available to support the organization’s strategic plans.

Top contractors are ahead of the curve in making succession planning part of their core management and leadership activities, and those organizations will continue to win the war for talent in a tight labor market. These same organizations should also be prepared to handle planned and unplanned management and ownership transitions as they arise.

Robert Murray

Executive Vice President, Head of Surety

robert.d.murray@zurichna.com

The information in this publication was compiled from sources believed to be reliable for informational purposes only. Any and all information contained herein is not intended to constitute advice (particularly not legal advice). Accordingly, persons requiring advice should consult independent advisors when developing programs and policies. We do not guarantee the accuracy of this information or any results and further assume no liability in connection with this publication.



About FMI

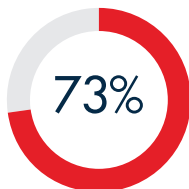
For over 60 years, FMI has been the leading **management consulting and investment banking** firm dedicated exclusively to **engineering and construction, infrastructure and the built environment**.

FMI serves all sectors of the industry as a trusted advisor. More than six decades of context, connections and insights lead to transformational outcomes for clients and the industry.

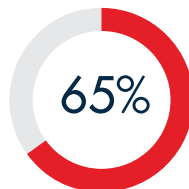
Sector Expertise

- A/E and Environmental
- General Contractors/CM
- Heavy Civil
- Industrial
- Specialty Trades
- Utility T&D
- Cleantech and Energy Services
- Construction Materials
- Building Products
- Oil and Gas
- Private Equity
- Owners

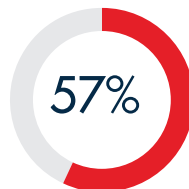
FMI Client Highlights



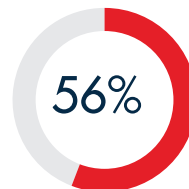
of the ENR
Top 400
Contractors



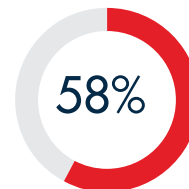
of the ENR
Top 200
Specialty
Contractors



of the ENR
Top 100
Design
Firms



of the ENR
Top 200
Environmental
Firms



of the ENR
Top 100
CM for
Fee Firms

Industry Focus. Powerful Results.™

Denver

210 University Boulevard
Suite 800
Denver, CO 80206
303.377.4740

Houston

9303 New Trails Drive
Suite 350
The Woodlands, TX 77381
713.936.5400

Phoenix

7639 East Pinnacle Peak Road
Suite 100
Scottsdale, AZ 85255
602.381.8108

Raleigh (headquarters)

5171 Glenwood Avenue
Suite 200
Raleigh, NC 27612
919.787.8400

Tampa

308 South Boulevard
Tampa, FL 33606
813.636.1364



www.fminet.com