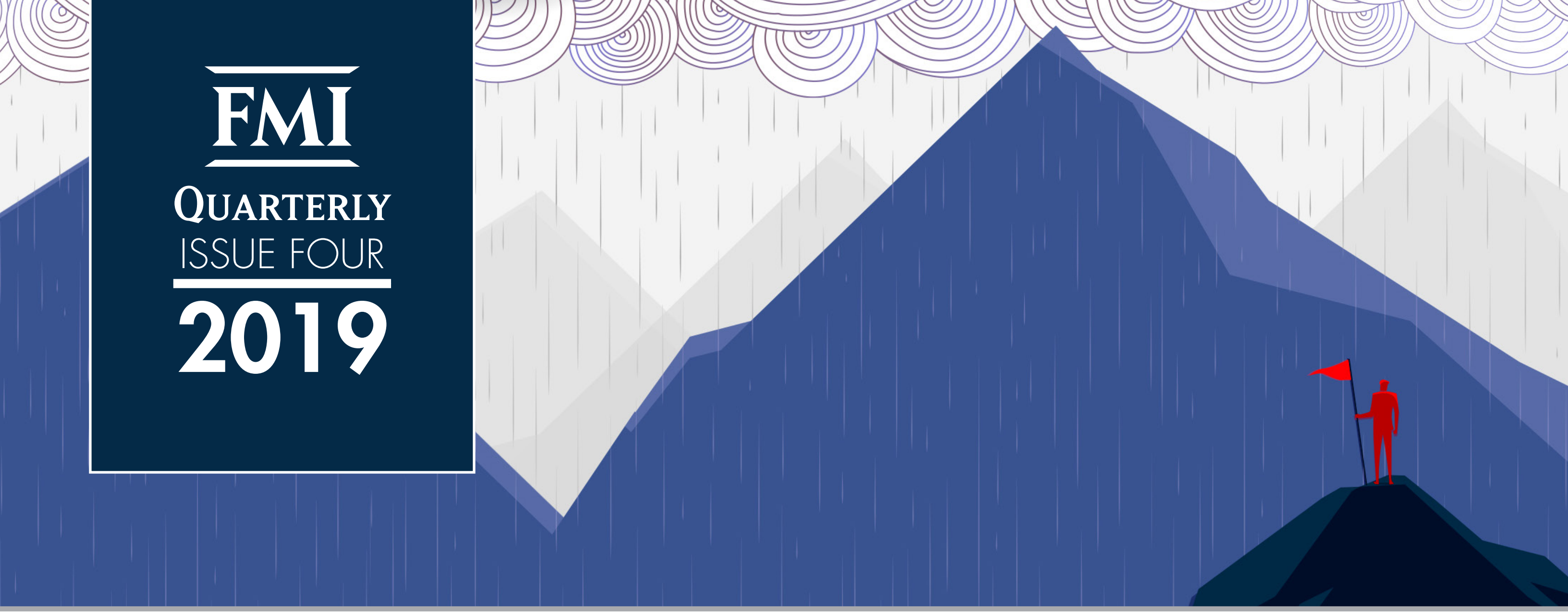

Strategy at the Top of the Cycle: Now Is the Time to Act

By Rick Tison

Ten years into the United States' longest period of economic recovery, is your company ready for the next downturn…or not?

The Great Recession ended 10 years ago, which means we're now in the middle of the longest period of economic growth on record in the U.S. Breaking a record 120-month upswing that took place between 1991 and 2001, the country has been on a record-setting pace.[1] Residential and commercial construction have played major roles in this expansion, and many engineering and construction (E&C) companies have been enjoying the prosperity that comes along with such cycles.

But as they say, all good things must come to an end at some point. And while we'd all like to think that the current business cycle upswing—now in its 10th year—will continue, the signs are already pointing to a possible downturn in the near future. Between 1945 and 2009, the average business cycle has lasted just over 5 1/2 years, according to the National Bureau of Economic Research (NBER). These cycles are measured from economic peak (or recessive trough) to the next.

Put simply, the U.S. is about 4 1/2 years overdue for a recessive trough. While E&C backlogs may still be full, capital markets are willing to lend, and clients remain active, now is <u>not</u> the time for companies to rest on their laurels and hope business stays brisk in 2020. In this article, we share insights from our latest strategy research and discuss what E&C firms can be doing <u>now</u> to ensure their success both during and after the next downturn.

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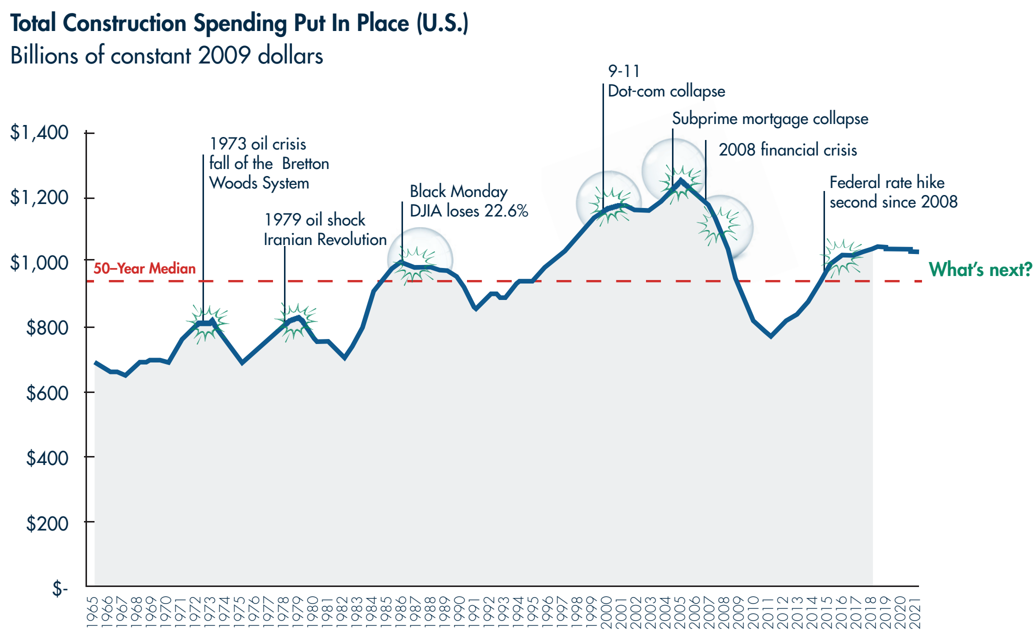
[1] "This is now the longest US economic expansion in history." CNBC. July 2, 2019.

Leading From the Top of the Market

So here we sit at the top of the market. And if history is any indication, a market correction is coming sooner than later. In fact, it's already overdue, which means that sometime in the 2020-21 time frame, we'll likely experience a general economic recession, as classically defined in the U.S. Specific to E&C, which this year entered its own 10-year-long period of increased construction spending, we're already seeing some anxiety on the part of industry stakeholders (**Exhibit 1**).

Exhibit 1. Where are we at in the construction spending cycle?



Source: FMI Q1 2019 Construction Outlook

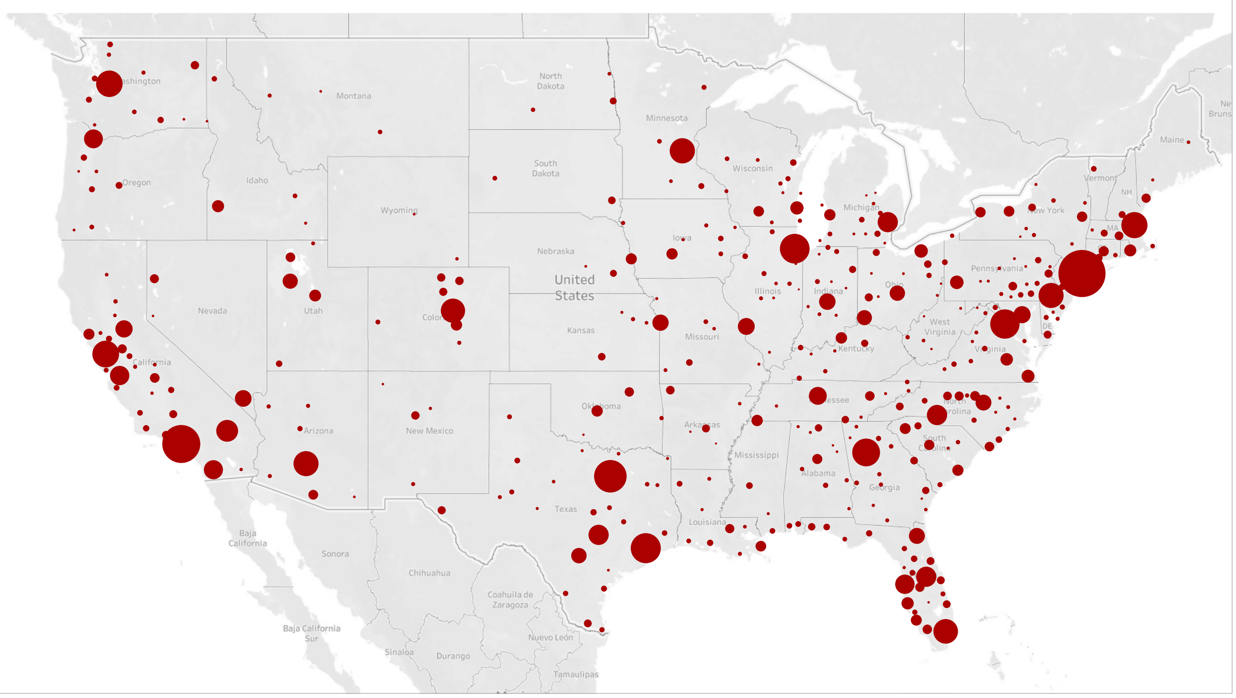
Surprisingly, our research shows that strategy drives focus on critical issues for just 15% of E&C firms. And only 40% say their strategy is based on an objective view of their context. This is a systemic industry issue in that many firms can't control their addictions to pursue new projects, clients or markets. If they haven't learned how to say no, they can get into trouble and wind up burning a lot of energy trying to get out of those predicaments—versus enjoying the ability to create a stronger equity base that establishes success for the future.

In fact, the contractors that will have trouble when the market turns—namely, those that already have "problems" on their books, in their backlogs or in their sales pipelines—will experience the biggest negative impacts of the downturn. Much like we saw with the Great Recession, those companies that don't have their ducks in a row going into the downturn will suffer the greatest negative consequences of the market shift.

It's important to note that E&C firms will experience different levels of impact from the downturn, depending on which customer verticals and geographic markets they serve. A heavy civil contractor in Los Angeles, for example, will experience a different environment than, say, a higher education builder in Boston will. Some of these variations will depend on the amount of construction being put in place and where those projects are located (see **Exhibit 2**).

The companies that take realistic snapshots of their own project pipelines and financial footings—while also factoring in the broader economic and E&C trends—will be best positioned not only to ride out the recession but also to come out ahead when the next recovery starts.

Exhibit 2. Construction Spending Is Concentrated in Fewer Markets



Total Construction Spending Put In Place by Metro Market (2018)
Forecast by Metropolitan Statistical Area (MSA)

Source: FMI Q1 2019 Construction Outlook

The Four Pillars of Good Strategy

Here's the good news: The U.S. economy has ebbed and flowed so many times over the last few decades that we now have the historical information, data, strategies and insights needed to be able to make good decisions before, during and after downturns. Here at FMI, we've come up with four pillars of good strategy that all E&C firms should be using all the time (and not just when a recession is looming). They are:

Pillar #1: Focus

At any economic stage, companies should be able to answer the critical "where to play" and "how to win" questions by identifying the right combination of markets, segments and delivery methods to outperform industry peers. Now this is not just about picking the right strategies and hoping that they stick. It's about understanding what drives value across different markets and segments and then figuring out how your company can deliver that value better than anyone else can. Focus on what you do best, find the clients/markets/segments that are actively seeking those qualities, and then drill down into those opportunities. This will not only help establish a solid foundation for your firm, but also keep it from spreading itself too thin by chasing around non-core projects and opportunities.

Pillar #2: Choice

No smart business takes every new project that's thrown its way, so why should yours? Even in challenging economic times, the companies that make conscientious decisions about who to work with (and why) tend to fare the best. Clearly frame your company's choices around future direction, knowing that good strategy depends just as much on deciding what not to do. For best results, focus on reconciling the tyranny of the urgent (i.e., today's fire drill) with the truly important (i.e., initiatives to create tomorrow's future). And remember that:

- When strategy does not wrestle with "fork in the road" decisions, it's probably not going deep enough.
- Too often, strategy becomes a task of creating a laundry list of initiatives and prioritizing them. (This is not inherently bad, but it could be an indicator you are not engaging at a deep enough level.)
- If you are evaluating a set of strategic options that wouldn't require different sets of initiatives to implement, you may need to push deeper.

Pillar #3: Systems

Even if your project backlog is overflowing and your financial picture is healthy, now is the time to get some systems in place to prepare your company for the next downturn. This means your management team will have to take a step away from putting out those "daily fires" and ensure that these and other systems are aligned to drive organizational strategy and success:

- Governance
- Corporate structure
- Rewards and incentives
- Performance management
- Leadership accountability mechanisms
- Labor management

These systems must all be aligned with the company's stated strategy. Without this alignment, decisions can often lead to tension within one or more of these systems. For example, if management wants to explore new geographic markets, but if governance isn't onboard with the idea, then the initiative can create friction between those stakeholders. To avoid these types of issues, be sure to evaluate the business for alignment between systems and strategy.

Pillar #4: Impact

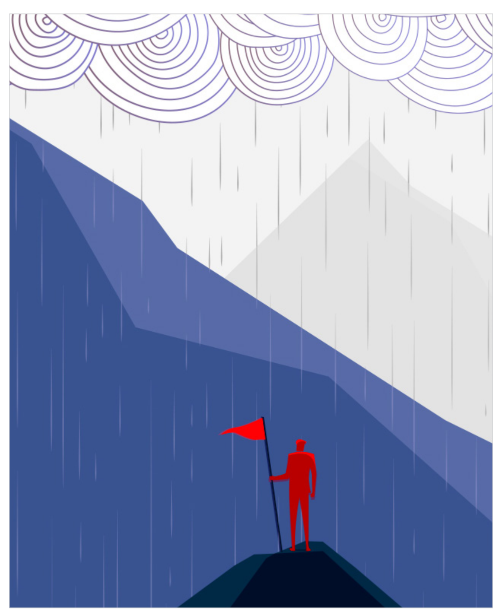
The strategy work outlined in the above pillars shouldn't just result in a "few good meetings." It must be impactful for the organization as a whole and—perhaps most importantly—have a positive impact on the company's financial statements. Your strategy is not what you say it is; it's a sum product of the day-to-day actions, decisions and behaviors of your people. That means every employee must be able to articulate the strategy, understand his or her role in it, and clearly understand how it impacts organizational success. Without these valued stakeholders onboard, any strategy will quickly fall by the wayside as employees just go back to doing things the "way they've always been done." This may have sufficed during a booming economy, but it can quickly derail even the best business initiatives during a downturn or recession.

Asking Yourself the Tough Questions

Developing a strategy requires understanding of context, making choices and acting on those choices. Ask yourself questions like:

- **Climate:** What is the demand outlook for our current and prospective markets? What trends underpin demand?
- **Customers:** Who are the leading buyers of our services? What are their procurement practices and preferences?
- **Competitors:** Who do we compete with? How is competition changing?
- **Company:** Are we positioned to exploit anticipated opportunities and build long-term value?

Use the answers to these questions to develop the major themes, prioritize ideas and set a critical path forward. Test and execute those ideas by figuring out what actions must be undertaken to implement the analysis of the priority ideas. Develop a business case and strategy; identify strategic and tactical considerations that you'll need to be able to execute the most important ideas; and then develop an implementation or business plan for executing the new idea(s).



Weathering the Storm

When people stop spending money, companies stop hiring new employees, and the industry stops investing in new construction projects, a downturn will ensue. This may not happen tomorrow or even next month, but based on historical data, it will happen in the near future. Knowing that uncertainty often leads to inaction, now is the time to start considering how you're going to future-proof your organization for the next downturn.

Based on what we know about the Great Recession and how it caught many companies off guard with its swift and lengthy economic downturn, there's literally no excuse for the same thing to happen again in 2020. Whether your company starts exploring new markets, firms up its balance sheet, tests the waters of megaprojects, or finds some other new way to compete, the key is not to wait until it's too late to do something about it. Kick off your strategies at the top of the business cycle versus the bottom, and you'll be much better prepared to weather the storm.

Rick Tison is a principal and strategy practice leader with FMI. Rick works with clients across the engineering and construction industry to develop strategies to improve company performance and profitability. He specializes in strategy development and organizational change. He can be reached at *rtison@fminet.com*.

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FMI has more relationships in the industry than any other consulting firm. We leverage decades of focused experience and expertise to advise on strategy, leadership and organizational development, performance, technology and innovation.

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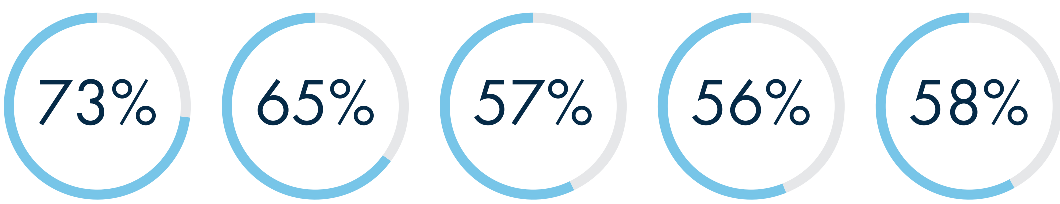

73%	65%	57%	56%	58%
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