# Construction 2021
## Rising from a pandemic

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## Construction 2021: Rising from a pandemic

# INTRODUCTION

So much has changed for construction companies in the past year. Wherever and however you do business, the COVID-19 pandemic has raised challenges for you and the entire industry that none of us imagined.

But the pandemic has also reminded us of lessons we already knew. As an industry, we realized profitability was a pressure point. We understood we had lagged other industries in adopting technology. And most of us recognized at some level that our succession plans needed some work.

We have also been reminded that our industry is resilient. While the pandemic has exposed our vulnerabilities, it has also pointed us in a direction forward. The most important changes we make during COVID-19 will live on long after the pandemic subsides.

*Construction 2021: Rising from a pandemic* addresses current challenges for construction companies and offers guidance on how to tackle them. In analyzing the landscape, the report focuses on the business needs of construction owners and operators, including trades. It is designed specifically for owner-managed businesses.

This report focuses on three timeless issues that dominate the current agenda for construction company owners: **profitability**, **technology**, and **business succession**.

As you move through the report, consider how the recommendations we present apply to your organization. Because while each of these issues stands alone, together they interact in countless ways. As a group, they serve as a reminder to ask this question of any business activity: How does it affect my business overall—now and into the future?

# THE PATH TO PROFITABILITY

Is your bottom line a race to the bottom? Change the rules.

With margins a constant concern for construction companies, small steps during the pandemic could spur big gains long term.

Tight profit margins inform almost every decision made by company leaders in construction. Precise margins vary based on type of company, but owners often target a minimum of 5% to 6% per project. In some cases, even that figure seems out of reach. A 2017 poll found that only 27% of major contractors saw 5% margins as realistic in the near future.[1] And a 2019 UK study showed gross profit margins declined in recent years after steadily increasing from 2008 to 2012.[2]

The main culprits for tight margins remain constant no matter the economic cycle. Low barriers to entry for new companies create a hyper-competitive environment. Materials costs spike from time to time. And skilled trades have become increasingly scarce in many Canadian markets, forcing companies to compensate their work at a premium. In Canada, the industry will need to replace 255,000 workers who are expected to retire by 2027, according to BuildForce Canada.[3]

Jobs continue to be tender based, where the lowest bidder wins the job. This places immense pressure on construction companies. In tough economic times, some companies resort to 'buying' work—reducing profit to zero.



*"Construction company owners are often surprised by the relatively easy steps they can take to boost their bottom line. But those steps can make a huge impact where they need it most. This was true before the pandemic hit, and it remains true today."*

**Matthew Peron, National Construction & Development Leader, BDO Canada**

### Pandemic and profitability: Past and future

The COVID-19 pandemic has challenged construction companies to get even more control over their profitability. The pre-pandemic shortage of skilled trades has increased. Lockdowns and new requirements for physical distancing have delayed some projects. Supply chains have been disrupted, raising the cost of some materials.

Many companies are also seeing their backlogs decrease as they complete projects. While some sectors—and parts of the country—have fared better than others, demand for work over the next 12 months is expected to be slow. RBC has projected a 0.6% decline in construction GDP from February to December 2021.[4]

Along with residential construction, infrastructure may hold out the most hope in the short term. The largest projects in Canada continue to trend upwards. According to ReNew Canada, the top 100 infrastructure projects for 2021 total just over $253 billion in investment, up from $240 billion in 2020 and far exceeding the $216 billion figure of 2019.[5]

If anything, the COVID-19 pandemic has sharpened the focus on infrastructure investment. The federal government has pledged to invest billions of dollars in infrastructure to kick-start economic recovery. In prioritizing green initiatives, Ottawa is embracing so-called shovel-worthy projects—not just those that are shovel-ready. The big question for construction companies: when will these stimulus funds trickle down to their job pipelines?

### Now more than ever, cash is king

The pandemic highlighted once again that year-end profitability isn't enough—especially for construction companies. Holdbacks up and down the construction pyramid require businesses in the construction industry to closely monitor cash flow at all times. During the pandemic, this became an even bigger issue. Delays, shortage of materials and labour, increased requirements for health and safety: they all added costs and tightened cash flow.



# HOW TO INCREASE PROFITABILITY

Aside from growing their topline revenue and improving productivity, construction companies can take several steps to tackle tight profit margins and increase profitability.

### The big reveal: Getting visibility on costs

Lowering costs remains an obvious step to improving profitability. But that first step sometimes requires a previous one: understanding costs and cash flow.

Construction companies often neglect the regular reporting that increases confidence in the business and lowers costs. In research from BDO New Zealand, almost 43% of construction companies described their reporting as limited or lacking.[6] This may indicate a deficit of in-house expertise on financial reporting and explains why many companies contract their financial strategy to an outsourced CFO or financial controller.

### Tracking costs, lowering costs

By tracking costs on every project and reporting the results, construction leaders can determine which projects generate a profit. They can build this experience into quotes for future projects.

Internally, they can direct this new information to forecasting and financial modelling, and to planning the year's activities. The owner of a construction company may cost a project to generate a margin of 5%, but overhead costs cut into those margins if not managed effectively. Overhead can be difficult to determine for an entire year. By allocating costs—for example, the costs of project manager, supervisor, or estimator—owners obtain more control over the company's costs and make better staffing decisions.

It may be worthwhile to go a step further: benchmarking business performance against competitors. From staffing models to margins, these insider looks at industry indicators help owners place their business in front of a mirror.

### From A-frame to Z-bar: Hundreds of government incentives

Many in the industry have relied on specialized government support to address COVID-19 challenges—particular during the pandemic. But they may overlook other government programs, which are available in a wide variety of forms and support a range of activities.

## What activities qualify for government incentives?

There are hundreds of government incentive programs across the country, offered at both the federal and provincial levels. The key for construction companies: identify activities that qualify for support.

**Accessing new markets**

**Green projects**

**Job creation, training**

**Adopting new technologies**

**Innovation, R&D**

**Capital investment**

Despite their value, government incentives go unnoticed by many companies in the construction industry. Small and mid-sized companies rarely possess the internal expertise to track the myriad of programs that exist across the country—or their changing requirements. They could be missing an opportunity. Some government programs actually prioritize support for smaller organizations, based on revenue or number of employees.

These government incentives may support an implementation of construction technology. Incentives even exist for third-party training on new software—such as an enterprise resource planning (ERP) system—or on-site automation.

### Making the most of government incentives

- **Focus on the program qualifications**
  Every program is designed with a goal and sets application criteria. Instead of describing the project only from your point of view, align your description with those criteria. Also, you may need to slightly adjust your project to meet the qualifications.
- **Always be proactive**
  Most programs aside from SR&ED require that projects be approved before you spend funds. Make sure to plan your project well in advance.
- **Think big**
  There are two ways use government incentives: narrowly and widely. Applying for government programs often nudges companies to hone their strategy. To exploit the opportunity of government incentives, grab this chance to think long term.
- **Do the math**
  Owners of construction companies sometimes receive pleasant surprises when calculating the benefit of government incentives. That investment you had rejected as too expensive may now fall within the company's budget. That best-in-class equipment may make financial sense, after all.



**WHAT IS SR&ED?**

The scientific research and experimental development (SR&ED) program is the most generous tax incentive for industrial R&D in Canada. Not only that—the Canadian tax benefits for SR&ED activities carried on in Canada rank among the most generous SR&ED incentives in the world.

Depending on the project, province, and type of company, Canadian owner-operated businesses can reduce their taxes by well over half of their qualified expenses. This reflects combined federal and provincial investment tax credit and corporate income tax rates.

### SR&ED: Incentivizing innovation

The scientific research and experimental development program (SR&ED) presents an intriguing opportunity for construction companies.

While the credit is best known in the tech ecosystem and on the manufacturing floor, SR&ED applies in a growing number of ways to construction companies. As an example, look to the Canadian Museum for Human Rights in Winnipeg. It is encased in a glass design called the Glass Cloud, composed of 1,335 panes of glass—and no two are the same.[7]

Work that is eligible for SR&ED may be performed by a specialized, third-party company. In that case, the construction company that enlists the third party could obtain the credit. Beware, though: the Canada Revenue Agency expects invoices to indicate that work was done on the construction company's behalf. If the invoice does not conform to the CRA's protocols, the third party may claim the credit come tax time.

### Tax strategies

There are many ways company owners can employ tax strategies to increase profitability. Much depends on the type of construction company, and no two are the same—but almost all construction companies may benefit from at least two.

The first involves tax structuring. Using this strategy, a tax professional helps determine how the company's shares are owned, and how the owner-operator takes remuneration. For example, it may make sense to hold shares of an operating company in a holding company or to introduce a family trust as a shareholder. What many owner-operators don't realize is they can adjust the company structure years after the company is established.

The second strategy relates to holdbacks. In construction, customers may 'hold back' part of the job payment until the work is complete and the holdback period has expired. This period allows the customer to review the work and have any deficiencies fixed.

The Canada Revenue Agency allows companies to exclude holdbacks from income if the amount has not been received from the customer. This allows the company to defer any tax payments on its holdbacks receivable to a future date, when the amount is actually received by the customer or the job is completed.

While basic forms of prefab have been used for thousands of years, the modern variety saw its stock rise in recent years, even before the COVID-19 pandemic. Then the pandemic hit construction companies—and prefab stood out as a way to increase social distancing.

## How prefabrication cuts costs

On profitability specifically, prefab helps companies by lowering costs in materials and labour:

- **Decreases wasted materials**
  The machines used in an off-site facility cut more precisely than less automated processes common in the field. In addition, because the facility often prefabricates many similar components, company owners can take advantage of economies of scale and produce less waste.
- **Lowers the number of workers needed**
  For example, framing is highly labour intensive. It also is a common activity for prefabrication. While assigning framing to prefabrication does not eliminate the need for framers, leaders can reduce the number of framers needed. In addition, prefab gives companies cost certainty by decreasing project delays and increasing efficiency.

Technology is especially conducive to the old-new construction practice of prefab. With building information modeling playing a lead role, contech makes measurements more precise—particularly valuable when assembling off-site. Some companies also employ robotics to support prefab.

## The green revolution

'Green' means two different things for profitability in construction. The first is a pain point; the second, an opportunity.

The pain point comes from customer requests for greener initiatives. Under frameworks such as Leadership in Energy and Environmental Design (LEED) certification, construction companies are asked to deliver final assets that sustain the environment—for example, by conserving energy. The construction industry strongly supports these initiatives. However, they do present a challenge: these requests increase the expenses on a project, yet customers sometimes expect the bid to remain the same.

But construction companies can find green opportunity. They can generate less waste in materials—a practice that is friendly both to the environment and to their bottom line. They may also receive government incentives for sustainable activities, such as using zero-emission vehicles on the jobsite. And companies may adopt a green strategy to grow sales, gaining expertise in the net-zero energy buildings that many see as the future of the industry.

## Construction profitability checklist

**Assess your operations against these questions**

- ☐ Have I explored all possible government incentives to support the business?
- ☐ Does any part of my work qualify for SR&ED?
- ☐ Have I made the most of tax strategies?
- ☐ Have I cut costs by outsourcing back-office functions such as CFO or financial controller?
- ☐ How can I implement prefabrication in my construction workflows?
- ☐ Should I pursue sustainable initiatives to help the environment—and my company's bottom line?
- ☐ Do I know my costs for all parts of every project?

***Looking to grow your bottom line? Reach out to our team to manage your costs, plan your taxes, and make the most of government incentives.***

**Matthew Peron, CPA, CA**
**Partner, National Construction & Development Leader**
**403-205-5768**
**mperon@bdo.ca**

# THE RISE OF CONSTRUCTION TECHNOLOGY

## Has contech turned a corner?

The recent spike in all things digital has construction owner-operators scanning a tempting list of opportunities and asking if the time is now.

To truly understand the construction industry's traditional approach to technology, examine a revealing study from 2016.

The report measured digital advancement in 22 industries. At the top sat the information and communications technology sector. Basic-goods manufacturing ranked No. 10. Construction came in at No. 21, just ahead of agriculture and hunting.[8]

Much has changed in five years, and the pandemic has further accelerated investment. According to one study, the industry pushed three years' worth of typical contech adoption into 2020.[9] The latest technologies solve challenges up and down the supply chain, saving time and money for everyone from owner to sub-subcontractor.

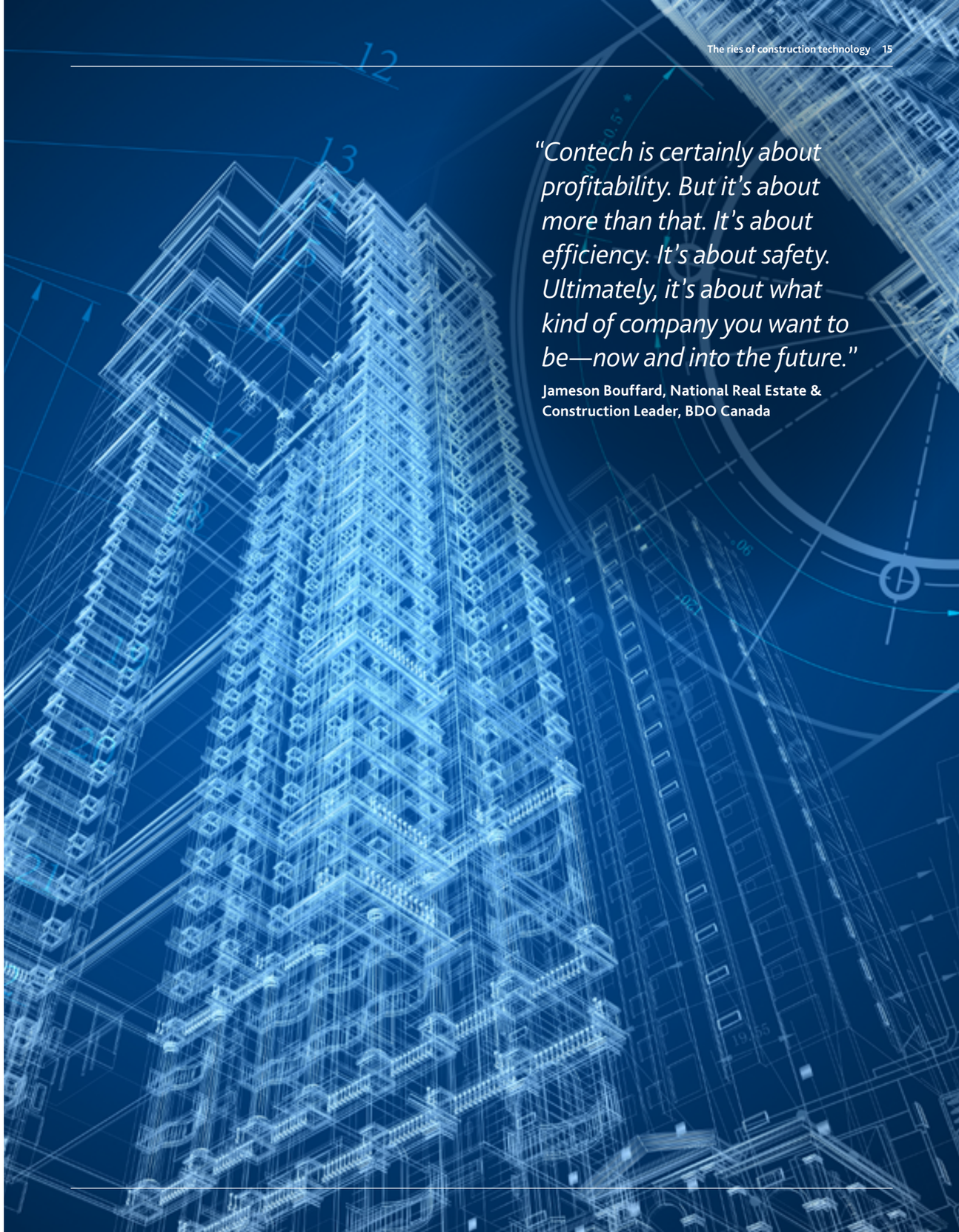
### The surprising truth about construction and technology

In many ways, construction is an ideal candidate for digital transformation. Construction projects are highly complex, connecting engineers, consultants, general contractors, tradespeople, owners, and architects—all working to build an asset. Communication often takes place via phone or email. Documentation typically takes place on paper. Collaboration, so important for any project, suffers. Enter technology: the connector of people and processes.

Contech also helps construction companies solve another well-known pain point: tight margins. When implemented correctly, contech can improve efficiency, keep projects on schedule, and decrease cost overruns.

And it's not just the bottom line that benefits from contech. Technology has grown topline revenues for many construction companies, at least indirectly. Contech automates manual tasks, freeing resources to strategize and develop new lines of growth and untapped opportunities.





*"Contech is certainly about profitability. But it's about more than that. It's about efficiency. It's about safety. Ultimately, it's about what kind of company you want to be—now and into the future."*

**Jameson Bouffard, National Real Estate & Construction Leader, BDO Canada**

# COVID-19 AND THE FUTURE OF CONTECH

The COVID-19 pandemic has increased the uptake of construction technology. Faced with unprecedented challenges to their operations, owners have made small and large bets on contech. What remains unclear is how long these changes will last.

In one survey of the construction and developer C-suite, collaboration technology use topped the list of pandemic-related changes most likely to remain post-COVID-19 (78% of respondents). This was followed by the increased use of safety technology (56%; respondents ranked several choices).[10]

Technology means different things to different people. Contech covers a diverse group of technologies that solve myriad challenges and continue to expand. As a result, construction companies looking to adopt new technology capabilities sometimes struggle to identify which solution is right-sized for them.

Most construction company owners—particularly of small and medium-sized companies—are choosing solutions for pinpoint challenges over full-scale digital transformation. This helps companies find solutions that fit the scale and budget of their projects.

## What's your approach to construction technology?

We've identified three primary ways construction companies engage with technology: early adopters, fast followers, and skeptics. Which do you prefer?

### The early adopters

Never content with your current operations, you seek out ways to introduce new contech applications before most of your competitors. This adds risk but also creates a first-mover advantage, helping you differentiate your business. It also helps you gain benefits as quickly as possible.

### The fast follower

You value technology and believe it helps your business stay competitive. But you would prefer to learn from your peers' successes and failures before implementing a given application.

Fast-following has emerged as the most common approach for small and medium-sized construction companies, who take contech notes from large construction operations.

### The skeptic

Why fix what's not broken, goes the saying, and you agree. You realize the risk of missing out, but you also think it's best to approach change with caution. You want to make sure a given technology helps your particular business. Every instance of contech needs to demonstrate a return on investment.

# BUILDING INFORMATION MODELLING: CONNECTING CONSTRUCTION

Among the many technologies driving the contech revolution, building information modelling (BIM) may present the most promise. While most construction owners and operators have heard the term, they may not know exactly what it means—or how it helps them.

But BIM continues to spread to job sites and back offices. The market is expected to triple in size by 2026, to US$15.7 billion.[11]

Let's explore one popular definition of BIM to gain a deeper understanding of this foundational concept.

"Building Information Modeling (BIM) is a ***digital representation*** of ***physical and functional characteristics*** of a facility. As such, it serves as a ***shared knowledge resource for information*** about a facility forming a ***reliable basis for decisions*** during its life cycle ***from inception onward***."[12]

## DIGITAL REPRESENTATION

### What it means

Creates a digital twin of the building or asset in 3D.

### Why it matters

The digital model simulates reality, allowing stakeholders to see how their plans will translate into reality and how their construction processes will interact with one another. They can identify errors early on and adjust accordingly.

BIM's digital DNA depends on more than just 3D, which computer-aided design already had employed. Every BIM model is created using data. (Hence the 'information' of BIM.) If the data changes, the model is also updated. It is this dynamic nature of BIM that makes it so valuable—by maintaining a consistent, real-time reference point for all stakeholders in a project and spurring collaboration.

BIM is both software and process. The software stores and updates the data and design, fostering the BIM process throughout the project.

## PHYSICAL AND FUNCTIONAL CHARACTERISTICS

### What it means

Sets out not only the physical structure of a building but also its functional inner workings and how they interact—for example, the lighting system, HVAC, and plumbing.

### Why it matters

As an example, consider the decision on the type of windows to include in a building. BIM shows how the choice of window impacts key variables: materials, labour, construction works schedule, and the building's heat load.

## SHARED KNOWLEDGE RESOURCE FOR INFORMATION

### What it means

Maintains and centralizes a single source of truth on the progress of the project.

### Why it matters

How can we connect all stakeholders in the construction pyramid? That is the question prodding much of contech development. For construction companies, BIM connects owners, general contractors, and subcontractors. It improves the flow of information on projects, with project teams and other stakeholders collaborating via a single platform.

## RELIABLE BASIS FOR DECISIONS

### What it means

The information stored in a BIM model helps project stakeholders adjust mid-project.

### Why it matters

In the project execution phase, project leaders continually monitor and control all aspects of the build. Through 3D modelling in BIM, they can see the consequences of decisions, making it easier to execute changes, redirect tasks, and manage resources. This real-time reporting gives project teams the ability to make more accurate project predictions.

Accurate adjustments can be made to scheduling, costing, and project dependencies as data becomes available. This saves time and money for all parties—by minimizing delays and cost overruns.

## FROM INCEPTION ONWARD

### What it means

BIM begins at the design stage for a project and continues even after the build is complete, to manage buildings or consider renovations.

### Why it matters

BIM brings together everyone involved in a project—architects, engineers, and the many other roles that make a construction job work. Success depends on more complete information, the ability to test multiple scenarios, and easier collaboration.

For construction specifically, BIM helps owners of construction companies plan and execute:

- Plan—predict the resources and time necessary to complete a project. The project team can also create documentation in parallel with design.
- Execute—adjust plans mid-project.

## Tech in the back office

How can construction leadership complete their office work when they're not physically at the office? That's the question many asked as the pandemic increased remote work. To the rescue came back-office technologies that increasingly integrate not only with accounting and payroll systems but also with applications on the jobsite.

In the coming months and years, back-office technologies will solve another acute issue: new legislation that mandates prompt payment and adjudication. Already in force in Ontario, the rules are designed to speed up payments in the industry. Provinces across the country and the federal government are expected to bring similar legislation into force.

To increase their chances of success in litigation, companies need to ensure they can access their documentation at all times. Recordkeeping must be robust and digital. Some companies can rely on legacy systems that are tweaked; others will need to invest in new systems.

## Protecting health and safety, staying compliant

Mobile applications for occupational health and safety (OHS) have gained popularity, as construction leaders search for ways to protect their workers, ensure compliance, and improve productivity.

At their most basic, OHS apps give employees easy access to up-to-date policies and regulations and a single source of everything OHS related. But OHS apps continue to grow in sophistication. Often using data, the newer apps streamline daily management activities and record workplace observations.

These applications can also be tailored to new uses. At the onset of the pandemic, some technology companies positioned their products to deal with the safety issues of COVID-19. Uses range from safety screening to attendance tracking to an AI platform that detects failures of workers to physically distance.

Sensors play an important role in the latest apps to improve health and safety. For example, they:

- Tell on-site personnel and management to respond to critical health and safety incidents in real time
- Alert drivers if their tractor exceeds the maximum speed
- Monitor specifications of concrete, such as strength, humidity, temperature, and pH level
- Notify workers and managers if the site generates too much noise or hazardous fumes



## The contech decision

**Four steps to get you from idea to implementation**

With so many technologies to assess, how can you select the best technology for your construction operations? Follow these four steps:

1. Identify
   Get started by bringing your leadership team's ideas to the table. What pain points are you trying to solve? What could be possible? Which technologies are available?
2. Qualify
   Assess every technology against your business, its values, and its culture. Does this technology solve your challenges? Does it improve your bottom line? Does it fit your infrastructure? How long will it take to implement?
3. Prioritize
   Select from the technologies you qualified. Which of those great options aligns best with your strategic objectives? What return on investment can you assign to each? Remember: saying yes to one contech opportunity means saying no to another.
4. Execute
   Implement your top contech opportunity or opportunities. You know which options will mean the most to your bottom line. Now integrate them into your operations, obtain guidance on how best to use the technology, communicate with your employees, and train them effectively.

Construction technology checklist

**Assess your objectives against these questions**

- ☐ Which of my specific pain points can technology best solve?
- ☐ How does this technology improve my bottom line?
- ☐ What's my contech style: early-adopter, fast-follower, or skeptic?
- ☐ Does the COVID-19 pandemic make a contech investment more acute—such as to support remote work or decrease transmission on-site?
- ☐ Can building information modelling help my construction company?
- ☐ How do my contech goals fit into my overall business objectives?
- ☐ How do I manage the change process for my employees?

***From organizational strategy to financial operations to cybersecurity, our professionals help clients fit contech to their business. Find out how. Reach out now.***

**Kyle Hulme, CPA, CA**
**VP, Strategy & Operations**
**Real Estate & Construction**
**437-990-6394**
**kyhulme@bdo.ca**



# TAKING CHARGE OF BUSINESS SUCCESSION

## Retirement beckons. Are you in control?

When mapping succession in construction, the toughest questions focus on finances and family.

Retirement tends to sneak up on owners of construction companies. One year, they cannot imagine leaving the business. The next, they may not feel like going into work. As a result, succession presents them with difficult decisions.

Recent research shows the scale of the challenge. Forty-eight percent of construction business owners over 50 have not considered succession or exit planning, according to last year's construction survey from BDO New Zealand.[13] These results track with Canadian research on small and medium-sized businesses. In a study released in 2018, the Canadian Federation of Independent Business reported that 51% have no succession plan. Of those businesses with a plan, only 9% had created a formal, written one.[14]

### Exiting during the pandemic

Economic uncertainty may decrease the potential for a sale in the short term—certainly for maximum value. On the other hand, COVID-19 has made succession more urgent for some in the industry. They have taken stock of their business and their lives, and reassessed their priorities. The silver lining for this segment of construction company owners: exits are best planned two years in advance of leaving the business. Anyone looking to exit can map their plans now; prepare the business, themselves, and their family for transition; and update their objectives as conditions improve.

### Business succession: Options and opportunities

For construction company owners, business succession touches on a host of questions that go beyond the nuts, bolts, and costs of their final big project. Family, financial independence, how to spend the retirement years: they all play key roles.

## Who will continue the business?

Owners often want their children to take over the business, but they are sometimes disappointed. Many in the next generation prefer another career. Some children want to work in the business but shy away from the responsibilities of ownership.

If the owner cannot find a family member to purchase the business, they can explore two options. In the first, an employee buys the business. Construction technology may help attract talented, ambitious employees, who eventually purchase the business. This 'hire the buyer' strategy can be quite effective. In the second option, a third party buys the business.

Some owners of construction companies face the opposite challenge: saying no to one or more of their children. When a child wants to take the mantle but lacks the passion or talent, the parent must find a way to explain why they have chosen another candidate—and still preserve the parent-child relationship. When multiple children want to carry on the tradition, the parent must yet again face difficult decisions and conversations.

Whatever decision the owner makes, they should communicate early and clearly. Explain the reasoning behind the decision and its full impact on each of the children and on the family. As part of the process, many owners use an integrated transition plan, which highlights communication via models such as a family council and advisory board.

## The role of employee stock ownership plans in construction

The employee stock ownership plan (ESOP) is a key part of business succession for construction owner-operators. An ESOP helps owners:

- Withdraw funds from the business over time to support their retirement
- Transition the business to a new ownership team
- Attract and retain talented employees

An ESOP allows a company's employees to buy shares in the company.

Some companies—either large or, in the tech world, startups—offer this benefit to all their employees as standard operating practice. Not so for many construction companies. They use the ESOP to enhance their business succession. The owner identifies an employee or multiple employees as candidates to take over the management and leadership of the business. If they wish to participate, the owner and employees execute the ESOP.

An ESOP typically gives employees the opportunity to purchase shares at a fair price and at fair terms. They can increase their equity ownership over time. It also allows employees to test life as an owner. Some will eventually decide that the burdens of ownership suit neither their lifestyle nor their pocketbook. With an ESOP, they can think and behave like an owner but shoulder fewer initial obligations and less risk.

## When to use an estate freeze

You may benefit from an estate freeze when transitioning your business to a key employee or to your family. Often used in conjunction with a family trust, this tax strategy 'freezes' the value of the business at today's value, pushing the future growth to the new shareholders. Estate freezes support construction company owners in two ways:

- **Estate planning**
  Adds certainty about the amount of tax due at death, and helps owners plan their estate.
- **Business transition**
  Allows them to take out equity from the company in an orderly fashion and gradually exit the business, and even maintain voting rights while stepping back from day-to-day management. This keeps control and the needed liquidity and working capital in the business.

## Beyond the numbers: Selling your business to an employee

Finances and figures go only halfway in executing a sale to an employee. Follow these tips to smooth the transition.

- **Create a shareholder agreement.**
  This agreement between buyer and seller outlines how the shareholders use the profits, how owners can exit the agreement, and how new owners come in. Ensure that the shareholder agreement covers the nuances of the construction industry.
- **Communicate the pros and cons of ownership.**
  Make sure your employees understand not only the benefits of ownership but also the obligations and responsibilities of an owner.
- **Be transparent on price.**
  Explain the valuation basis for your requested sale price. Not only does this create trust—it educates your employees on the risks to the business and its cash flow.

# KNOW YOUR WORTH: VALUING A CONSTRUCTION COMPANY

Selling a construction company has much in common with bidding on a construction project. To excel at both, the owner needs to establish the market value of the asset or service being offered.

To find out a company's worth, valuation professionals consider a list of factors that vary by industry. Construction differs from manufacturing, which certainly differs from technology companies.

Construction companies often stumble not in valuing the company but in not valuing the company early enough. Many picture a sale as the outright purchase of the company by an outside entity. In truth, any transfer of shares qualifies as a sale—including an ESOP. The owner should know the company's value before transferring any number of shares.

Private equity firms scout profitable companies in every industry—including construction. And larger construction companies do sometimes buy smaller or midsized companies with a construction specialty, as a strategic purchase. However, valuations for small to mid-size construction company owners most often take place when transitioning their business via an ESOP or a sale to family members.

## 10 FACTORS THAT DETERMINE A CONSTRUCTION COMPANY'S VALUE

Owners can anticipate their transition by enhancing their company's value before sale. Valuations professionals consider 10 top factors when valuing a construction company:

### 1. Margins

With margins often tight in the industry, cost management is key, and prospective buyers need to understand the company's cash flow. Is the company working from project to project or adding profit and market share?

### 2. Business dependence on founder

The first generation of the business often maintains many core relationships with customers, suppliers, and key trades. Can the business preserve those relationships if that key individual is no longer active?

### 3. The economy

Company values fluctuate between economic recession and upswing, and some parts of the economy are more vulnerable than others. Much depends on geography and construction type, but it may help to diversify the company's customer base. Construction during the COVID-19 pandemic has fared better than some other industries; still, the outlook remains uncertain in the short to medium term. How are your customers poised to emerge from COVID-19?

### 4. Job pipeline

A strong job pipeline bodes well for the near future of the company. That said, also consider how much revenue is recurring, whether business is generated through word of mouth based on good reputation, past performance, and customer quality. As a result of COVID-19, companies should especially consider which projects in their pipeline are at risk of deferral, scope changes, or outright cancellation. One question to ponder at all times: Does your company need a business development professional to increase its pipeline?

### 5. Specialization

Buyers will place a greater premium on a company with a technical specialty—such as building for railroads—than on a construction company that pursues general construction projects. These niche companies can often bill work at a higher rate. Does your company enjoy an established niche?

### 6. Safety record

A company history littered with lawsuits indicates not only an operating risk. It also shows that the company is not run as well as other construction companies. The pandemic forced companies to add new layers of safety to protect their employees. Has your construction company instituted the necessary safety protocols on the job site?

### 7. Geography

Company valuations vary widely based on geography. In Canada, expect to see differences across the country, from province to province, from city to city, and even within cities. Is your company's region of focus in demand?

### 8. Industry

Some companies perform most of their work for a specific industry, and that industry could impact the valuation. For example, construction of new mines may possess a smaller growth profile than other industries. Does your company focus on a specific industry? If so, what are its prospects?

### 9. Equipment and technology

If a purchaser needs to invest substantially in the business post-purchase, they will expect to pay less to buy the company. For capital equipment, consider the age and condition of the equipment fleet. For technology, remember that contech adoption may differentiate your company for purchasers. And in the coming years, you will most likely need to upgrade technology in your operations just to keep pace with the industry. Which technology adds the most value for a buyer?

### 10. Legislation and government investment opportunities

Governments focus their spending or incentives on a sector, subsector, or region. A government may prioritize investments in specific forms of infrastructure. The federal government has said it will do so to spur economic recovery from the COVID-19 pandemic. Also relevant are opportunities for public-private partnerships. On the other hand, new legislation could increase compliance requirements for a new owner. Does recent or future government activity impact your company?

Construction succession checklist

**Assess your exit plans against these questions**

- ☐ When do I want to exit the business?
- ☐ Who will buy the business—family member, employee, or third party?
- ☐ Have I communicated clearly and transparently with family members and employees?
- ☐ Should I create an employee stock ownership plan?
- ☐ What is my business worth today, and how does that compare with my desired value upon exit?
- ☐ Does an estate freeze make sense for me and my business?
- ☐ Have I created a retirement plan to preserve my wealth and legacy after exit?

***Business succession waits for no one. Get the best value for your business. Control the timing of your retirement. Manage your family relationships. Reach out to us now.***

**Jeff Noble, CMC, FEA**
**Director**
**905-272-6247**
**jnoble@bdo.ca**



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**MATTHEW PERON**
**CPA, CA**
Partner, National Construction
& Development Leader
403-205-5768
mperon@bdo.ca

**JAMESON BOUFFARD**
**CPA, CA**
Partner, National Real Estate
& Construction Leader
416-369-6039
jbouffard@bdo.ca

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