ECONOMIC

The Financial Recession of 2008:

How It Affects BSCs

By Gary Penrod

LIKE OTHERS IN THE UNITED STATES AND THE world, those of us engaged in the building service industry began 2008 with guarded optimism. However, as the year progressed, it became increasingly clear that the United States and the world were facing a financial/credit crisis of huge proportions.

The extent of the problem became clear when, on September 15, 2008, Lehman Brothers crashed, following the government bailout of AIG, the world's largest insurance company, and the Treasury-brokered sale of Bear Sterns to JP Morgan Chase.

Gradually optimism gave way to pessimism and fear as the magnitude of the crisis became clearer. We learned about corporate greed and governmental ineptitude. We were astounded by the collapse of banks, other financial institutions and, in the United States, the devastated automobile industry. There have been lively debates in the halls of Congress and in the news media about where to set the blame and what the best course of action might be to not only fix the immediate problem, but also ensure it doesn't happen again.

Never in recent history have the American people looked to their government leaders to take appropriate action more than they are now. Regardless of one's political preference, most Americans hope the new administration will succeed in its efforts to calm the situation and bring about a return to financial stability. History has shown us that ordinary people rise to become extraordinary during extraordinary times of crisis. This will likely be the case during the immediate future. Some experts think that third quarter 2009 will be the beginning of a return to stability, but others disagree, so individuals can only shore up their own businesses as required, doing their part to help.

The building service industry, while recession-*resistant*, is not recession-*proof*. Depending on the market area in which BSCs operate and the market sectors they serve, the impact of the current crisis will vary by company. Obviously, contractors in Michigan and other areas that provide services to automobile-related customers will feel the impact more than contractors in the Southeast that provide services to institutional, medical or other customers less affected by the crisis.

Also, those companies in any market area providing services in any market sector—that have operated at a high performance level with ample cash reserves and little or no debt—will likely fare well too.

So here we are in the middle of a financial crisis. What do we do now?

Don't Panic. The good news is that this

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too will pass. Action, even if in small, positive steps, will ease the panic and help the situation.

Cut Expenses. Do so in a manner that does not affect the service level to customers. Many companies operate with the credo, "We've always done it this way." Maybe it's time to say, "What if?" Small efficiencies add up, sometimes to significant amounts. There are no sacred cows! Consider reductions for all line items, including shareholder compensation and perks.

Accelerate Debt Reduction. Use increased liquidity from cost reductions to reduce debt or to build cash reserves.

Understand How Your Customers Are Affected by the Crisis. It's important to not lose customers, even if, by necessity, revenue from a customer is reduced. Anticipate the new requirements and discuss ways that specifications can be adjusted so that there will be minimal impact on quality. Contact the customer before he comes to you. This has been done often by contractors during past financial downturns and has usually resulted in keeping the customer while maintaining existing profit-margin percentage. You may experience slower pay from some customers, who will be leveraging their payables because credit is tight or unavailable elsewhere. Work with them as much as you can, but be prepared to take decisive action at some point.

Stay Alert and Aware. Ignoring the situation and how it can affect you usually leads to inaction, which can have disastrous results for a company, its shareholders and employees. The news media is only one source of information. Rely on others too: peers, bankers, published works and those who have successfully experienced similar situations in the past. Using multiple sources and staying alert will prepare you for the coming storm and properly position your company once it blows over.

Keep Employees Informed. These are times when *everyone* has to pitch in. To do so, employees need to understand the situation and how they can best serve themselves by serving the company and its customers.

What About Growth? Financial crisis or not, there is still opportunity to grow. Be selective. Understand how the financial situation affects the prospective customer. Consider start-up costs and the likelihood of long-term retention. Be prudent, growing within your means. Recessions end. Maintain your core values by not slashing costs to the point of not being a good and competitive company when better times return.

Each Customer Needs to Pay His Way. Few contractors have 100 percent of their customers contribute equally. There are usually some that do not. Now may be the time to analyze whether or not a given customer is worth the effort. Disengagement would be the last resort; however, in some cases, it may be necessary to free up dead weight.

Risk Management. Every company, large or small, must understand and manage risk. Don't just *have* risk management, *practice it.*

It is very likely that, as in the past, the building services industry as a whole will weather the current crisis very well. However, there will be cases of individual companies that may not fare well due to factors beyond management's control. In some cases, failure will be due to poor management and inaction. Some companies will simply be pushed over the edge by this particular situation, having been well on the way to failure anyway. This year—as during other periods of challenge—will require strategic thought and action.

For many companies, the current crisis may provide a lesson, offering necessary motivation to make the requisite changes that will serve them well in both good and bad times. In this respect, the situation we find ourselves in can be viewed as an opportunity. Some changes may take years to effect – an example being the shift from dominance in one market sector to another. Companies dominated by one or a few accounts may take this opportunity to focus on selective growth so that the overall customer list gradually lessens the company's reliance on a few customers to strike a better balance in customer diversification. Other positive changes such as labor efficiency, supply and other line-item controls can be effected in a relatively short time, providing almost immediate results.

It is likely that the current crisis will have some impact on company valuations in some cases, but not all. However, because this industry is not the same as the housing industry, the resulting impact may be evidenced by less activity in the mergers and acquisitions sector of the industry. Prospective buyers hoping to complete acquisitions through debt funding are less likely to be successful. However, well-funded, qualified buyers will still be looking for well-managed companies with a history of good performance. Poor performing companies, on the other hand, will be more apt to be passed over, or will result in lower valuation multiples.

Complacency is our enemy, whether in good times or not. Sometimes it takes a crisis to jolt us out of our complacency. So in that respect, the current financial downturn can be viewed as an opportunity to make a company more prosperous and able to withstand the inevitable hard times when they arrive. The way you manage now will determine how well you do when the recession ends and the good times return.

Gary A. Penrod is president of Gary Penrod and Associates, Inc. in Hilton Head Island, SC and can be reached at (843) 681-6588.