Construction Quarterly

Why Bench Strength Is Your Best Risk Management Tool

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Having a strong bench of future leaders can help mitigate risks that could threaten long-term success.

Last quarter, we explored how construction companies can attract, retain, and develop a talented workforce. For the latest Construction Quarterly, we want to look at bench strength from a risk mitigation strategy angle. The deeper your bench, and the higher quality that bench is, the better equipped your organization may be to withstand risks that could threaten your ability to build long-term company value.

Today's Workforce Builds Value Through Strong Operations

Your workforce is one of the most important value drivers you have. Your people are the ones executing jobs, pushing for innovation, and building strong relationships, all of which lead to stronger financial statements.

But there's a subset of your workforce that adds value in a completely different way.

Value Drivers
Value drivers are the characteristics that influence a company's profitability and value.

Tomorrow's Leaders Build Value Through Risk Mitigation

Next-level managers are employees who have been hand-picked by existing leaders to take over the business. We call this group of employees your "management bench," since they can be ready and waiting to be called into position despite not currently managing the business.

Next-Level Managers
Next-level managers are the employees you've identified as future leaders.

Next-level managers will be leading the business during and after the transition by ensuring operational continuity, supporting existing employees, and making it easier for exiting leaders to step away. They have a lot of important tasks to handle, and big shoes to fill. If those next-level managers don't have what it takes, or if you fail to identify future leaders at all, you could be inadvertently devaluing your business.

Consequences of Having a Shallow Bench of Future Leaders

When your existing leaders are performing well and the business is operating as it should, selecting people to replace them can feel like wasted effort. However, we encourage construction leaders to identify and develop future leaders (even if your managers plan to stay for some time). Acting now can help mitigate risks down the line.

Key Person Risk
Key person risk is the vulnerability a business faces when it is overly reliant on only a handful of key leaders.

This is a phenomenon known as key person risk. When your business's success relies too heavily on the actions and knowledge of just a handful of individuals, the market will likely discount the value of that business.

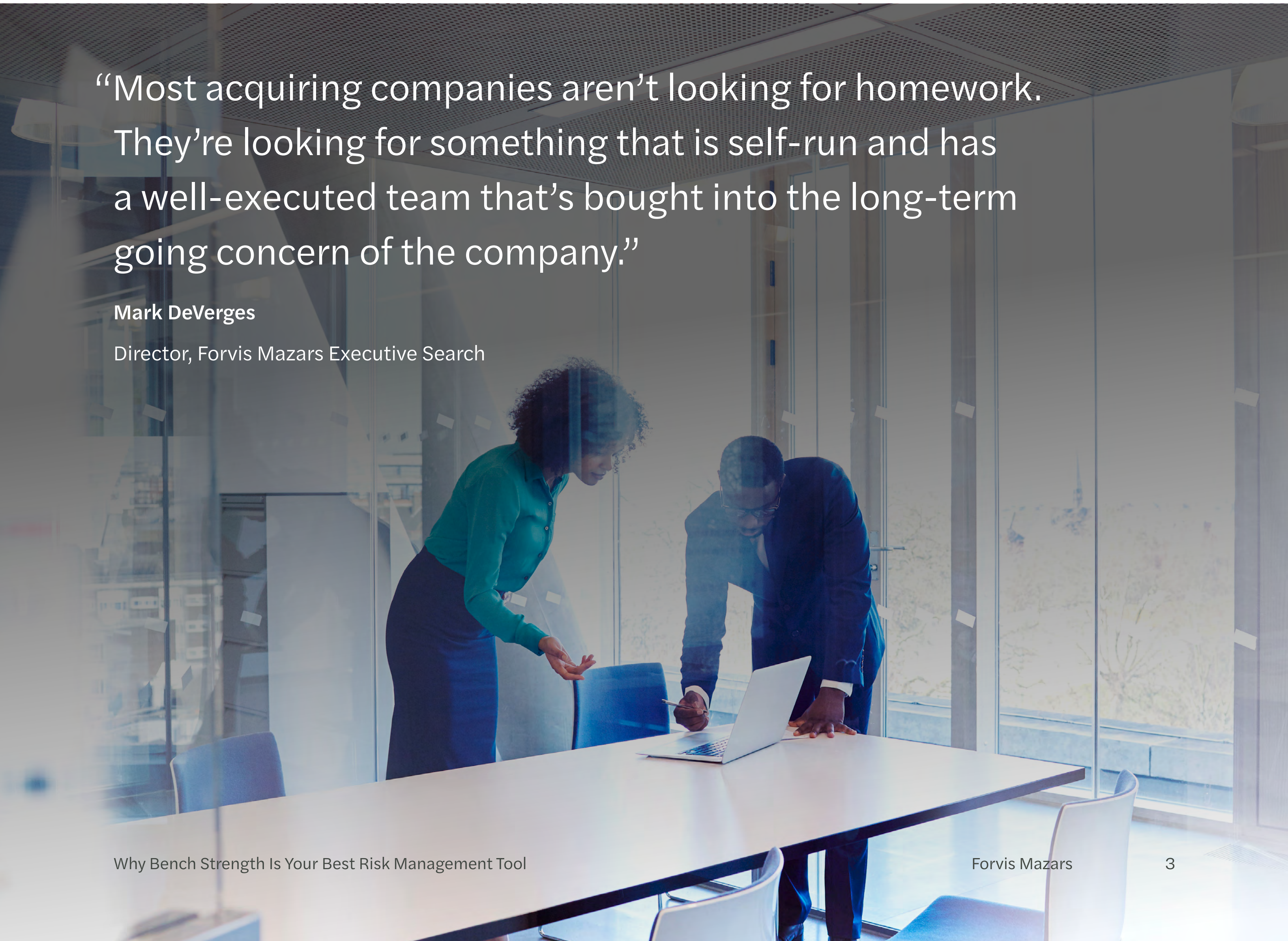
When there's key person risk, prospective buyers (or investors, sureties, or lenders) may make the following assumptions:

- A transition would be rocky.
- Institutional knowledge won't get passed on.
- There's less innovation.

"Most acquiring companies aren't looking for homework. They're looking for something that is self-run and has a well-executed team that's bought into the long-term going concern of the company."

Mark DeVerges

Director, Forvis Mazars Executive Search



Consequences of Having a Shallow Bench of Future Leaders

A Transition Would Be Rocky

Prospective buyers want a business that runs itself. If that business is only functioning smoothly because of the actions of one or two key leaders, there's more assumed risk to the transaction. Buyers, for example, may be worried that after a transition, the new managers will:

- Prioritize the wrong things
- Not have the experience necessary to lead a team
- Misunderstand or misinterpret planned strategic moves
- Be rejected or disrespected by employees
- Have different goals than exiting managers

If current managers were to leave, the incoming leaders may have a difficult time replicating past financial performance. This makes the business less appealing, and valuations may take a hit.

Consequences of Having a Shallow Bench of Future Leaders

Institutional Knowledge Won't Get Passed On

If key leaders leave unexpectedly and their successors aren't fully trained and developed, important institutional knowledge could be lost, like:

- The best ways to maintain positive relationships with difficult suppliers.
- Which clients value speed, and which clients value price.
- The types of contingencies to use with each type of job.
- The best way to resolve disputes before they escalate.
- Which suppliers are most responsive, ship the fastest, or give you preferential treatment.
- Common pitfalls when bidding certain types of work.
- Lessons learned from past projects that aren't formally documented anywhere.
- Which numbers on a financial report are early indicators of trouble.
- How teams or individuals stay motivated.

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There's Less Innovation

Labor is increasingly harder to come by, which forces the industry to do more with less. This makes innovation a near necessity to keep profits from shrinking. Unfortunately, tenured leaders often struggle to embrace new solutions.

Buyers and investors know this. They know that the next generation of leaders are often the ones to make suggestions, embrace change, and take risks like adopting new technology solutions. Without next-level managers pushing for digital transformation, businesses may be perceived as less adaptable, and therefore less valuable.

How to Manage Key Person Risk

Play through a simple scenario in your head. Ask yourself what might happen if you and your fellow leaders retired tomorrow. Would your largest customer stay? Would employees stick around? Would your successors have the confidence and experience to run the show? If your answers to these questions are "no," then you likely have key person risk.

Managing key person risk is necessary to future-proof a business, and it may help improve the outcome if you're pursuing a business valuation. Here are four things you can do:

1 Build your bench.

Identify the individuals you want to take over when you leave. If you're hoping to fill your bench with current employees, then you can review their performance, look at their past leadership experience, and make sure they're bought into the idea. In addition, it is worthwhile to consider outside hires for comparison.

2 Train your successors.

Send future leaders to formal trainings, and let them shadow you as you go about your job. Let them ask questions, and document your personal processes and philosophies if they're not already written. As they gain confidence, start delegating important tasks for them to manage without your assistance.

3 Test their abilities.

If you believe your bench of future leaders is ready, put them to the test. A great time to do this is during your planned vacation or sabbatical. By letting them test their skills in a controlled environment, any disruption that may occur would be low stakes and short lived.

4 Make yourself less visible.

Prospective buyers want a business; they don't want you. Separate yourself from the business as much as you can. If the company bears your name, consider changing it. If you're prominent in its messaging and marketing, then send others in your place. In addition, let someone else call the shots if employees typically needed to hear a directive from you before acting. Let the company be its own entity rather than an extension of you.

Key Person Risk May Undermine Success

Key person risk slowly and quietly erodes the value of everything else you've built. A healthy balance sheet, loyal suppliers, a strong pipeline, efficient operations, and thorough risk management policies all contribute to a stronger valuation. Don't let key person risk be the thing that discounts it.

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