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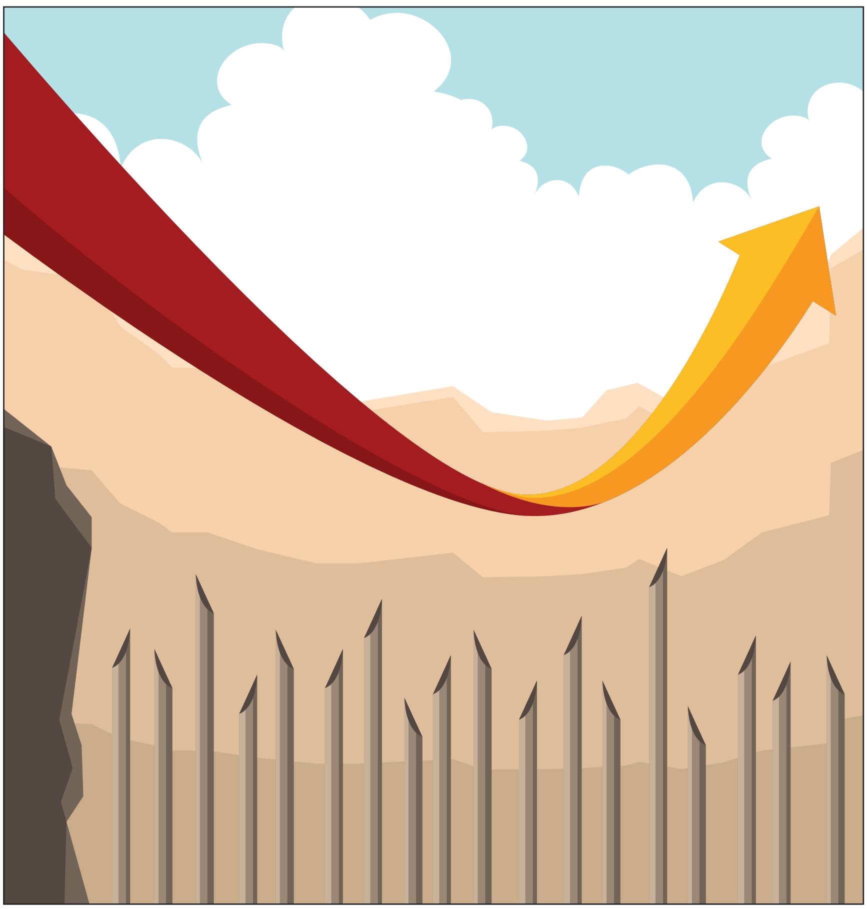
MANAGING RISKS FOR *Post-Recession Opportunities*



Surviving the Great Recession probably required some belt-tightening at your company, so the current recovery is welcomed as good news. But, managing risks in an improving economy requires caution, thought, and planning.

Fortunately, careful risk management can also bring new opportunities.

Whether it's internal risk (lack of market diversification, labor pool issues) or external threats (changes in insurance, bond scams), recognizing and formulating a strategy to address these factors will help you successfully navigate them.

Managing Construction's Shrinking Labor Pool

Recent studies report that while construction is picking up, the industry lacks skilled workers. In some regions, immigration laws, in addition to the economic downturn, have prompted workers to leave construction. And, the dearth of new workers entering the field means that the current workforce is aging, with the average age now about 47.[1]

As the industry rebounds with a labor pool that's notably smaller and older, the resulting lack of both skilled and unskilled labor is a significant challenge. The fact that for every four skilled tradesmen retiring in the U.S., only one is being replaced through traditional apprenticeships comes as little surprise given the industry's negative image. There is a potential bias about getting into construction, often fueled by political leaders or the media. The importance of trade schools isn't promoted as much as a college education, and construction is often portrayed as a low-income or unsuccessful career path by the media.

You can cast a wider net, but if you compromise your standards in a tight labor environment, various problems can arise. For example, our clients report that workers' comp accidents often involve the newest employees. If this is the case in your company, then consider implementing a mentor/protégé program where a senior/tenured employee is assigned to a new employee until he or she is fully acclimated and onboarded.

While there's no one solution to the shrinking labor pool, there are untapped resources that can result in finding employees who may strengthen your company in the long run.

Students of Construction

College students and interns are an underutilized source that can eventually feed into your skilled labor pool. Industry associations are trying to make construction more appealing to high school students; a company involved in such programs will have an edge on finding the best talent from this group.

In Georgia, for example, the "Go Build Georgia" program sponsored by the Governor's Office of Workforce Development works with industry representatives to attract students to the skilled construction trades as a career. The campaign includes media outreach and partnering with high schools and technical colleges to offer skills competitions for students. The program also promotes the effort by recognizing those schools that perform well in advancement of construction education with awards and press coverage. There is interesting data and valuable information for young people who are considering construction as a career option at *www.gobuildgeorgia.com*.

Women & Immigrants

According to the National Association of Women in Construction (NAWIC), as of 2011, women only represented 9.2% of the construction workforce. If your company needs workers, consider tapping into this labor pool that makes up about 47% of the total workforce. Of the women in construction, the vast majority (87%) are employed in the office end of the business. These statistics would seem to indicate that opportunities for women to expand their role in the industry are huge.

Moreover, progressive employers are going to recognize this fact and use it to help grow their companies. As construction becomes increasingly technologically sophisticated, the opportunities for women in a traditionally male-dominated industry can only increase. Although they are still underrepresented, now is a great time to encourage women to enter the industry.

Some companies are even bringing talent in from outside the U.S. and by sponsoring workers in both skilled and unskilled labor. This tactic has a significant initial cost in finding the right candidates, and there are a number of logistical hurdles, but returns include a high level of worker loyalty. We work with a Columbian-owned contractor client that has used this strategy extensively to source highly skilled engineers and equipment operators from their home countries. As a result, it has successfully built a quality workforce with very little staff turnover.

Current Employees

Construction is a creative, entrepreneurial industry that can be a stepping-stone for opening a business. Contractors deal with every facet of business, from personnel and equipment to capital investment and logistics. Those in the industry need to work on promoting it as an employer/career of choice.

Pay careful attention to your most valuable employees, and create a system to train and retain the employees who elevate your company. For the first time in five years, employees are being recruited from other employers, and workers are being offered raises and increased benefits. Be proactive in recognizing excellent work with financial rewards. Make working for your company a mutually beneficial proposition.

Regardless of where a company finds its labor, one thing seems certain: with a smaller labor pool comes higher wages. The unavoidable strategy is to manage other costs as tightly as possible and be more open to higher wages (and possibly better benefits) as a way to attract and retain quality workers. Also, when bidding work it will be important to factor in some sort of inflation figure for rising labor costs.

Technology Investment

One of the positives about coming out of a difficult economy is that construction companies in a healthy state have fine-tuned their processes and tightened their cost structures. Part of an increasingly tech-savvy industry, contractors are spending money on technology and moving themselves along the sophistication curve. That investment may save money that can be moved to education, training, and wages.

We have recently seen several impressive labor-saving applications for tablet computers in the marketplace. These can be used to improve documentation and enhance quality and safety efforts. Pay attention to these developments, as investments in technology can pay very large returns.

Time for Diversification

If your company depends on a certain kind of project, another way to create new opportunities in a recovering market is through diversification. The most successful companies that came through the recession were able to diversify markets. Many of those that did not diversify had to downsize or went out of business.

One example: We have a client that was 100% retail construction (e.g., shopping centers and grocery stores) five years ago. The company significantly diversified into product types, which are less sensitive to the ups and downs of the economy and customers, and is coming out of the recession stronger as a result. Today, that client is building libraries and university buildings in addition to retail buildings.

When diversifying, be sure to "walk before you run" and validate the risks inherent in changing markets. Things like anticipated payment timeliness, quality/availability of subcontractors, and contract terms and conditions can vary across markets. Don't "bet the company" on a large project before your team understands all of these risks.

Diversifying in a tough market can be challenging because everyone is trying to do it. Now, when the market is improving, is a better time to take that risk. If you're not diversified to the extent you want to be, then study other markets, figure out how to break in, and hire the right people to make it happen. Diversification requires some management focus, and you must be able to prove to your clients that your company is prepared to take on this new challenge.

Beware of Bonds

During a downturn, contractors' balance sheets often take a hit, leaving them struggling with cash flow. When the economy starts improving, their credit may not be strong enough to take advantage of the upswing.

Unable to find bonding through traditional sources and frustrated at lost opportunities, these companies are more susceptible to bond scams. Remember, if it seems too good to be true, then it probably is. Having said that, there are practical steps you can take to avoid being duped.

It is most important to know the provider with whom you are working. A great place to look is an association of which you may already be a member. (Most reputable agencies are affiliated with or members of construction-centric associations such as CFMA, AGC, and ABC.) When researching a provider:

- Check references (at least three or four) for the agent.
- Beware of sureties incorporated or domiciled outside the U.S., as those jurisdictions typically have lax or non-existent regulatory requirements.
- Check with the state insurance commissioner's office to verify that the surety is licensed in the state where the project is located and not under any kind of regulatory scrutiny.

Make sure the information requested is in line with the industry requirements. The NASBP and Surety & Fidelity Association of America (SFAA) are good resources. Some red flags to watch for include:

- An agent looking for payment upfront
- Bond rates higher than 3% for first-time principals
- Agencies that don't ask for underwriting and credit information (it's required)

Check the surety's professional credentials. Sureties that lack an A.M. Best rating and/or do not appear on the U.S. Treasury Listing of Approved Sureties are rarely legitimate providers (unless they are able to provide a "cut-through" to a reinsurer that has agreed to "stand in" for them).

Changes in Insurance

EMR

To encourage a more responsible employer culture, the National Council on Compensation Insurance (NCCI) created the Experience Modification Rating (EMR). The intent of the EMR is to reward those employers whose loss results outperform the average while penalizing those who underperform. The EMR represents either a credit or debit that is applied to the premium before discounts are applied. Individual employer cultures can have a dramatic impact on losses and thus premiums paid over time.

The EMR evaluates a company's losses and payroll over an experience period – normally three consecutive policy periods, not including the most recent year. At its essence, it is an actuarial comparison of actual losses with expected losses for a given period and payroll level.

Primary losses are those under the given "split point" in effect. (This is currently being updated in many states.) Amounts over this split point are considered "excess losses." Losses are tracked and coded by injury type and level of disability and weighted in a mathematical formula. Medical-only claims are also tracked and discounted significantly in most states to incentivize the reporting of such claims.

EMRs are most responsive to "small claims" under the split point threshold. For the past 20 years, this number has held at $5,000, even though average losses have tripled during that time. Beginning in 2013, the split point rose to $10,000, then it will rise to $13,500 this year, and finally $15,000 in 2015, after which it will be indexed beginning in 2016.

Just as you monitor payment history, potential credit lines, and available credit to debt ratio to maintain your credit score, you should also devote a similar amount of time to the experience mod formula. Watch the number and size of claims, insurance company reserving practices, and other factors to optimize this important scorecard. Also, work with your broker to ensure the calculations are based on accurate data. (Mistakes can happen just like with credit scores.) It should be a key strategy in an improving economy. Be sure to ask: "How low could my mod score be, and what can I do to make it lower?"

Things You Should Know About **Your Company's EMR**

1) It is the biggest single controllable factor affecting your workers' comp cost.

2) Your company's customers are using it as a measure of quality and safety to prequalify your company.

3) Your minimum EMR is what it would be with zero losses.

4) Your controllable EMR (the difference between your actual EMR and your minimum EMR) represents your potential improvement.

5) Small but frequent losses are weighted more heavily.

6) Infrequent but severe losses can be due to lax safety or poorly managed or nonexistent Return to Work policies. They can also be exacerbated by inadequate injury management procedures and poor communication with injured workers. Work with your carrier and broker to establish best practices as they can translate into big savings.

7) Understand the experience mod impact of losses. The single-year impact of each loss can be measured and then multiplied by three to determine the total cost that your company is paying in increased premiums over a three-year period.

Balancing the Requirements of the PPACA

By now, your company has hopefully taken the time to understand the impact of the *Patient Protection and Affordable Care Act* (PPACA).

One of PPACA's sweeping changes is the move from a risk rating for some groups to a community rating for all. Community rating will not be neutral and will either help or hurt your company's bottom line. Determining its long-term impact on your company upfront will provide a guideline on how to structure its employee benefit coverage at a reasonable cost. Remember that while the PPACA officially took effect at midnight on Jan. 1, 2014, all of the changes won't happen overnight.

From an expense perspective, you have to manage both the hard and soft dollar costs that come with being in compliance. For example, some employers are considering cutting staff hours to 29 per week or less to avoid the insurance requirement, but doing so risks higher staff turnover and therefore an increase in training expenses.

In a tight labor market, companies that cut employee hours are probably not offering the most attractive benefit/pay package to attract and retain the best employees. Conversely, in a labor market where employers have a hiring advantage, they may have more leeway with adjusting employee hours.

For larger companies that continue to offer competitive benefits to their employees, the main challenge will be ensuring that they stay in compliance and avoid incurring penalties. That challenge brings a good bit of increased administration.

The new insurance marketplace may call for revisions in your company's culture. Some questions to ask include:

- Can our company afford to offer coverage to spouses who have coverage through their employers?
- As a company, are we comfortable not offering coverage to our employees' families?
- Does our plan meet the minimum value and affordability requirements? If not, then what changes do we need to make in 2014 to prepare for 2015?
- How can we better manage the company's health care expenses through plan designs?
- Can we use wellness incentives to help manage our health care expenses?

Government Budgets & Potential Projects

Many state and federal budgets were hit hard by the economic downturn and are not showing any signs of recovery yet. They're slowly improving but have yet to return to pre-2008 levels.

As those budgets recover, new projects may come down the pipeline. Since the budgeting process for these projects can take years, marketing efforts must be retooled in anticipation of those markets returning. Many companies may have stepped away from government work in recent years, but it may be time to revisit and renew those relationships.

Conclusion

We are very glad to see the construction economy finally recovering. Many tried and true surety maxims have proven themselves during this downturn.

While there is still no substitute for a good business model, sound systems and processes, and a strong balance sheet, contractors that get ahead of the risk factors discussed here may help their companies outperform their peers in the current recovery. ■

Endnote

1. Georgia Governor's Office of Workforce Development, *www.gobuildgeorgia.com*.

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