Staying the Course When the Training Wheels Are Gone

Ensuring the Long-Term Viability of Minority-Owned Contractors

BY ALEXANDER A. CALDERONE, MANAGING DIRECTOR, CALDERONE ADVISORY GROUP LLC
& BRANDON S. MACKLIN, MANAGING DIRECTOR, BRHEN-TECH LLC

CONSTRUCTION

Since the late 1970s, federal, state, and local government agencies have established programs to help socially and economically disadvantaged entrepreneurs gain access to the economic mainstream of American society. While there are differences among these programs, in most cases the contracting agency establishes subcontracting set-aside goals that mandate that prime contractors use disadvantaged subcontractors for a portion of the work under the contract. It is not unheard of, however, for some programs to also establish goals under which a disadvantaged business serves as a prime and/or sole-sourced contractor.

To be considered a qualified disadvantaged business, the general rule of thumb is that the organization must be at least 51 percent owned and controlled by disadvantaged persons. While the definition of "disadvantaged persons" varies across agencies, the U.S. government generally identifies socially disadvantaged individuals as those who have been subject to racial or ethnic discrimination and cultural bias because of their identities as members of groups and without regard to their individual qualities. The federal government generally identifies economically disadvantaged individuals as socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same or a similar line of business who are not socially disadvantaged.

In most instances, Americans of African, Hispanic, Native American, Asian Pacific, and Subcontinent Asian descent whose net worth falls below certain thresholds qualify as disadvantaged. For the remainder of this article, the terms "disadvantaged" and "minority" are used interchangeably.

Many platforms, such as the U.S. Small Business Administration's 8(a) Business Development program, are helpful in jumpstarting the operations of minority-owned construction contractors with significant, and sometimes immediate, revenue-generating opportunities, specialized business training, counseling, and marketing, financing, and bonding assistance that would not otherwise be available to them. However, these programs are often temporary and

continued on page 12

continued from page 11

expire after a specific period of time or upon achievement of certain financial milestones. Furthermore, even with this level of assistance some minority-owned construction firms find themselves ill-equipped to adequately manage the rapid growth driven by these programs.

As a result, there are typically two reasons minority-owned construction contractors may stumble into financial distress: (1) They fail to build the requisite financial and operational infrastructures necessary to manage explosive and often exponential growth stemming from the very same assistance that is meant to breathe life into the business in the first place; and (2) They are unable to regenerate lost revenue once agency-directed assistance is no longer available.

A Double-Edged Sword

In recent months, the authors have been approached on a number of occasions by financial institutions interested in providing capital to minority-owned construction contractors that have grown rapidly from mom-and-pop operations to become legitimate contenders in their respective trades. In some cases, their stories were unquestionably true rags-to-riches examples of disadvantaged entrepreneurs using various set-aside programs available to them to achieve the American dream.

Although each situation was unique, many of these contractors eventually faced the same problem—credit analysts at their respective financial institutions could not validate the reasonableness of financial projections provided by these prospective borrowers. In some instances, additional red flags were also present, such as the absence of historical and projected financial and operational dashboard reporting metrics, qualified CFOs, and a general lack of analytic rigor within the accounting and finance departments of these organizations.

Further investigation into these issues revealed that generally the root cause was simple: the organizations had grown rapidly, thus increasing the complexity of the operation, while their managerial structure, systems, and process-related infrastructures had not kept up. The same accounting teams, project management teams, operations teams, accounting information systems, etc., that were responsible for running very small organizations had been little augmented, even though the size and complexity of the businesses had increased quickly.

In one instance, for example, only after a tremendous amount of resources had been spent to pursue a new project did a contractor determine that it could not even handle the work, given its existing capacity constraints. Another contractor determined that, due to working capital constraints stemming from contractual payment terms that the minority-owned contractor's finance team had overlooked, it could not perform an executed contract that had been expected to generate significant profit and cash flow. Neither of these situations ended up being financeable. The owner of one company who was out seeking growth financing one day was introduced to his bank's workout officer the next—an unfortunate and highly preventable turn of events.

While these issues are not uncommon across minority-owned construction contractors, they are definitely preventable. As one would never attempt to drive a car without a working fuel gauge from New York to California, a business owner should not expect to grow his or her business from $1 million to $100 million in annual revenue without developing the requisite financial and operational dashboards that are necessary to manage such expansion properly. When minority-owned construction contractors learn that investing in people and processes is just as important as investing in capital assets or marketing budgets, if not more so, success and long-term viability usually follow.

While this type of investment in managerial infrastructure is par for the course in organizations backed by sophisticated and actively engaged financial constituents, such as private equity funds, high-net-worth individuals, and/or Wall Street investors, it is often not the case in the realm of minority-owned businesses. Revenue growth driven by government set-asides can be so explosive that the need for a more complex infrastructure can arise overnight. In many situations, there is little time to plan for this.

The key to success is simple—infrastructure must grow along with the business. The construction industry is ripe with opportunities for minority-owned contractors because a significant number of governmental set-aside programs fall within the scope of construction projects. However, construction contractors don't sell widgets and the nature of the business therefore requires a higher level of analytic rigor than other industries. Each project is unique and uses different materials, types of labor, and subcontractors. Knowing precisely how historical and projected cash flows are being generated and used by each project, a necessary skill for all construction contractors, is particularly important for a rapidly growing minority-owned enterprise that wishes to remain viable over the longer-term.

The construction industry is ripe with opportunities for minority-owned contractors because a significant number of governmental set-aside programs fall within the scope of construction projects.

Going the Distance

Most set-aside programs are designed to help minority-owned contractors generate the initial revenue required to ramp up operations and develop a scalable business model. These initial revenues play an important role in the embryonic stages of the business. They enable an organization to develop critical relationships with larger prime contractors through subcontracting arrangements while also building the track record necessary to secure additional commercial work when it is no longer eligible for the set-aside programs.

In a perfect world, minority-owned contractors would graduate from set-aside programs with strong

continued on page 14


Because nothing
beats delivering
for a client.

continued from page 12

relationships and significant records of past performance, both of which would enable the companies to compete in the open marketplace without additional governmental assistance. However, far too often a minority-owned construction contractor instead finds itself struggling to survive after governmental training wheels are removed.

Why does this happen? Again, the primary reasons are both simple and preventable.

Anyone familiar with the construction industry would unquestionably agree that the best marketing resource a contractor can possibly have is a reputation for being able to complete projects competently, on-time, and within budget. In far too many situations, minority-owned contractors, impatient and hungry for growth, take on work for which they are either unqualified or not yet large enough to competently perform.

Such a blunder can result in the permanent blacklisting of a contractor from future projects, particularly in local circles where poor performance is quickly and pervasively exposed to all relevant industry participants. Sometimes the most important decision a minority-owned contractor can make is to decline a project that would otherwise cause major performance problems for the company. First impressions are very important, and professional reputations should be protected at all costs.

While set-aside contracts are critically important during their formative years, minority-owned construction contractors should begin revenue-diversification planning early on in their companies' life cycles. Sole reliance on easily obtainable but temporary set-aside revenues is a recipe for disaster in the long term. As such, developing customer diversification is just as critical as generating exceptional past performance.

There are far too many instances of seemingly overnight successes turning into horror stories when the large federal contracts that they were working on expired. In fact, some critics have used this pervasive issue in attempts to discredit federal set-aside programs. The prepared minority-owned construction company can preemptively address this issue by focusing on it in the early stages of the company's life and vigorously pursuing industries and service lines with strong potential for growth.

While DBE, MBE, SDB, and various other acronyms used to denote disadvantaged businesses can be critical in forming teaming arrangements with larger prime contractors and obtaining initial projects, they can also, over time, begin to overshadow the legitimate competencies that many minority-owned businesses develop. In some circumstances, this phenomenon creates significant obstacles for enterprises that are both qualified and capable of performing more lucrative, value-added types of work that fall outside the scope of set-aside programs. The ultimate goal of any minority-owned business should be to develop the types of skills, capabilities, and record of past performance on which future commercial project awards will be based.

A Higher Ideal

Although they are sometimes abused, the fundamental spirit of the various public-sector agency set-aside programs that incubate minority-owned businesses is not to discriminate against non-minorities or to provide minorities with some sort of unfair, long-term economic advantage. Rather, these programs are designed to provide equal opportunities to disadvantaged individuals who are willing to work hard in exchange for a fair shot at the American dream.

Many of today's turnaround professionals have become hardened to the woes of their clients' financial distress, particularly in the aftermath of the Great Recession, when more corporate graves were dug than ever before. The chance to help a minority-owned business survive and thrive should be viewed as more than the typical "hours-for-dollars" engagement. It is a meaningful way for members of the profession to help bring the kind of transformative progress that is needed to revitalize underserved communities and reduce racial and economic tensions in America—which seem to be at an all-time high—all while enhancing the productivity of the overall U.S. economy. J

Alexander A. Calderone, CTP, is managing director of Calderone Advisory Group LLC (CAG), a boutique turnaround consulting and litigation support firm servicing the national middle market. Calderone has provided turnaround management, due diligence, and capital raising services to numerous construction contractors and their creditor constituencies. In addition to his CTP certification, Calderone is a CPA/ABV, CGMA, and a CFE. He can be reached at alex@calderoneag.com.

Brandon S. Macklin serves as director of business development and operations for BRHEN-TECH LLC, a minority-owned consultancy specializing in developing and executing revenue augmentation strategies for both non-disadvantaged and disadvantaged businesses and/or those seeking to develop teaming relationships with them. Prior to founding BRHEN-TECH, Macklin spent nearly a decade at General Dynamics Land Systems, where he was responsible for the management and oversight of multiple U.S. Department of Defense contracts exceeding $500 million. He can be reached at bmacklin@brhen-tech.com.

In 2014, CAG and BRHEN-TECH formed BRHEN-TECH / Calderone, a strategic joint venture to provide strategic advisory services to disadvantaged businesses and/or parties seeking to develop business relationships with them.