



Dermody, Burke & Brown, CPAs, LLC

# Dimensions

A CPA's Report for the Construction Industry

Winter 2023

## Succession Planning

# Succession Strategies for Construction Firms

Succession planning is something that business owners know they should do but often put off. In fact, nearly half of all small business owners say they haven't named a successor yet, according to the Service Corps of Retired Executives (SCORE).

This can be even more problematic among contractors and construction firms. These owners are often the face of the company, which can make it harder to relinquish control to others. New technology and the growing complexity of the construction industry can also make it harder to find a qualified successor who can step right in and take over.

It doesn't matter how or why you depart the company—you could retire, start another business, or be forced to leave due to a serious illness or disability. The important thing is to create a detailed plan for how your ownership stake and decision-making authority will be transferred to a successor owner or owners.

### When Should You Start?

It's never too early to start succession planning. Ideally, you should begin the process at least three to five years before you plan to exit the business. This will give you more control over your exit and better succession options to choose from.

Here are a few important questions to think about as you begin the succession planning process:

• **What are your succession goals?** For example, do you want to

maximize the sale price to fund your retirement, or is it more important to preserve your personal legacy in the business?

• **Do you want to keep the business in the family?** If yours is a family construction business, is there a family member who is qualified (and willing) to become your successor?

• **Are there key employees who need to be retained after you leave?** If so, what kinds of incentives can you offer to motivate them to stick around?

• **Are you willing to finance some of the purchase price?** Owner financing could expand the field of potential buyers, but it also entails financial risk that you might not be comfortable taking.

### Succession Planning Options

There are several different succession options to choose from—the best one will depend on the circumstances surrounding your exit. Here are four types of succession plans that construction firms commonly use:

**1. Transition to heirs.** Keeping your business in the family may allow you to preserve your legacy while handing your heirs a successful enterprise. But transitioning your business to heirs can be tricky. The first challenge is choosing a successor. If one family member is helping you run the business right now, the decision could be easier, but there could still be hurt feelings among other family members who aren't chosen.



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## Focus on: Technology

# Use Tech Tools to Automate Construction Workflows

Many construction firms and contractors are more productive because they use construction management technology tools that help them schedule projects, manage resources more efficiently, and automate workflow processes.

That's the good news. But there is a flipside: Some firms are drowning in data, which is hampering project management and causing headaches for project managers and executives.

A recent survey set out to determine the current state of construction workflow processes and how contractors are using technology tools in their daily operations. The Foundry MarketPulse 2022 survey asked leaders from more than 100 construction firms how they are adapting their workflows to accommodate digital technology.

Here are five key takeaways from the survey:

### 1. Lack of Visibility is a Challenge

The inability to see data clearly is the biggest technology issue facing contractors today, according to the survey. Seven out of 10 respondents said a lack of visibility into the availability and delivery status of materials is their biggest business challenge.

Lots of moving parts must align for a construction project to finish on time and within budget, which makes visibility critical. Forty-two percent of respondents say a lack of real-time information about profit margins and project status is a top challenge, while 39 percent cited a lack of visibility into all project-related information as their biggest challenge.

### 2. Safety Management Workflows Lead to Inefficiency

Health and safety regulations are in place for a reason: to protect construction workers and others who are on the job site. Contractors must regularly report to OSHA and their governing authorities about how they're complying with these regulations.



However, safety management workflows are the main reason projects fall behind. Forty-five percent of respondents said that safety management is the leading cause of inefficiencies, even though these processes can be easily automated. Spend management and scheduling, both listed by 42 percent of respondents, were other leading causes of project delays.

### 3. More Tech Isn't Always Better

There's no end to the ways that technology can be used in construction projects. Sixty-one percent of respondents said their firm uses multiple software tools, while 25 percent said they use specific software for individual workflows.

But this isn't always a good thing. Construction firms may be wasting time searching for the right apps or software or trying to remember which one has the data they need to finish a task. Only 13 percent of respondents said their firm manages all their workflows using just one software platform.

### 4. Technology is Most Often Used in Scheduling

Schedule management is inefficient and causes a series of delays for contractors. So, it's not surprising that nearly half of the respondents (48 percent) said their firm uses technology

tools to automate scheduling tasks and make scheduling more efficient.

### 5. New Tech Tools are a Key to Success

Most respondents said their firms are continually looking for new technology tools that can help them improve processes and boost efficiency. Just 3 percent said they only seek out technology when they're desperate. And 30 percent said they're always on the lookout for tech tools that can improve workflows.

Many tech tools that construction firms use are industry agnostic and lack customization and construction-related features, however. Some contractors are turning to no-code and low-code software non-IT workers can use to build custom programs that help them better control their workflow.

### Use Technology Wisely

Workflow automation is crucial in construction. It can boost the efficiency of complex projects by automating tasks that otherwise must be completed manually, such as scheduling, budgeting, reporting, estimating, and bidding. Your firm can optimize workflows by using technology to automate these and other tasks.

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*Contact our firm if you'd like to discuss workflow automation in more detail.*



## Succession Planning

# Succession Strategies... Continued from page 1

The most important factor in your decision should be who is most qualified to lead the company, regardless of personal feelings. Once you have named a successor, start training him or her so the future leader is prepared to take over when you leave. Involve the successor in important decisions, and introduce him or her to key clients and vendors.

**2. Sell to one or more co-owners.** This could be the best option if you have partners in the business who are willing to buy you out. A buy-sell agreement is usually the best way to execute this kind of transfer. A buy-sell agreement is a legally binding document that details the terms of a partner buyout, including what happens to a partner's ownership shares if he or she dies or becomes permanently disabled.

Cash value life insurance policies or a disability buyout policy typically fund a buy-sell agreement. There are two main types of buy-sell agreements. With a cross-purchase plan, each part-

ner buys a life insurance policy on the other partners. With an entity purchase plan, the business entity buys life insurance policies on each partner. This type of plan is best when there are three or more partners.

**3. Sell to employees.** Selling your business to employees can be a win-win: You gain the satisfaction of transitioning your business to people you know and trust, and your employees benefit from greater stability and the opportunity to reap some of the rewards of business ownership.

An employee stock ownership plan (ESOP) is a good way to transition ownership to employees. With an ESOP, you can liquidate ownership gradually by selling employees a minority interest in the business over time, thus retaining a controlling interest. A big benefit of ESOPs is the positive impact they have on employee morale and productivity. Many employee-owners work harder and are more loyal to the company when they have an equity stake.

**4. Sell to an outside buyer.** Third-party business buyers are usually competitors who want to expand market share by acquiring your customers or other businesses along the supply chain (like vendors and suppliers) looking to expand their operations. Selling to an outside buyer is often the most straightforward process. It also tends to yield the highest payout and avoids potential complications that can arise when passing your business on to family members.

Before listing your business for sale, focus on specific value drivers to help boost your business' value and potential sale price. See the following section for three key value drivers.

### Get Started Now

If you haven't devised a succession plan for your construction firm, now is the time to get started. Meet with your key business advisors, including your CPA and attorney, to discuss the details of succession planning for your contracting business.

## Three Key Value Drivers

You can potentially boost the sale price of your construction firm by focusing on these key value drivers before listing your business for sale:

**1. Financial performance** - Business acquirers are looking for companies with strong growth potential, high margins, and steady cash flow. So, focus on improving financial

ratios like your gross and net profit margins, return on assets (ROA), and return on equity (ROE).

**2. Bench strength** - Acquirers also want to see a deep management bench to help ensure that the transition goes smoothly. Focus on strengthening your management team and incenting them to

remain with the company after you leave.

**3. Competitive advantages** - Why do customers choose to do business with your firm? What makes you different from (and better than) your competitors? Know your unique selling proposition (USP) and emphasize this to potential acquirers.



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## Be Aware of These Inflation Reduction Act Changes

The Inflation Reduction Act of 2022 (IRA) includes several changes that could impact contractors and construction firms.

First, the IRA lowered the minimum annual savings in energy costs required to receive the Section 179D Energy Efficient Commercial Building Deduction from 50 percent to 25 percent. Owners who construct new or renovate existing energy-efficient buildings may receive a tax deduction of up to \$1.88 per square foot. This lower threshold will go into effect for property placed in service on or after January 1, 2023.

The Act also provides higher deductions for owners who meet prevailing wage and apprenticeship

requirements. If these requirements are met and the building achieves a 25 percent reduction in energy costs, the deduction rises to \$2.50 per square foot. The deduction increases by \$0.10 for each additional percentage of reduction, up to a maximum deduction of \$5.00 per square foot.

In addition, the IRA removes the lifetime limit on the Section 179D deduction beginning in 2023. Contractors and firms can now take the deduction every three tax years if additional cost savings are realized as a result of new energy-efficiency improvements. Also, both public and tax-exempt organizations (e.g., religious institutions, private schools and hospitals, and museums) can now

allocate the Section 179D deduction to designers.

Finally, the Act established a new retrofit program. This is an election for a new alternative deduction for energy-efficiency retrofits. The goal of such a retrofit is to reduce the intensity of energy use rather than total annual energy costs.

*Give us a call if you have questions about how these changes could affect your projects.*



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