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Foundations for the Future: Succession Planning for Construction Companies

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Planning Today for Leadership Tomorrow.

For many owners in the construction industry, succession planning seems less important than the current projects, bids to submit, labor challenges to address, and clients to serve. Construction companies also face unique challenges in succession planning to protect their reputation, maintain client relationships in competitive markets, maintain bonding capacity, hold on to specialized expertise and a skilled workforce, which are all closely tied to the owners and leaders of the organization. Ownership transition can disrupt any of those critical elements, especially if lenders, sureties, or major customers lose confidence in leadership continuity. Therefore, thoughtful succession planning may be one of the most consequential business decisions a construction company will make.

Whether an owner hopes to preserve a family legacy, reward key employees, maximize business value, or ensure the company continues to thrive in their community, a well-designed succession plan can help achieve those goals. Conversely, failing to adequately plan for the future can create uncertainty for employees, customers, suppliers, and family members while potentially destroying the value of the business. Owners should begin evaluating succession options well in advance of an anticipated transition. While every situation is different, below are four common succession paths for construction companies; family transfers, management buyouts ("MBOs"), employee stock ownership plans ("ESOPs"), and strategic sales that highlight practical advantages and drawbacks to consider.

Maintaining the Family Business.

Many construction companies are family-owned businesses, making a transfer to the next generation a natural consideration. A family succession plan involves transferring ownership and leadership responsibilities to children, in-laws or other relatives. A family transfer can maintain the company's reputation, identity, and culture while keeping ownership within the family. Keeping a business in the family also reassures customers, partners, and employees when they can count on the stability that comes with familiar leadership. This form of succession planning may also provide owners with flexibility to mentor family members over time, helping them gain the experience needed to lead successfully.

However, family transfers also present potential drawbacks. For example, one of the most common challenges is finding a family successor with the desire, leadership ability, and industry knowledge needed to run the business. Succession decisions can also create tension among siblings or other relatives, particularly when ownership and management roles are not aligned. Even capable family successors may face challenges earning the trust of employees, clients, and industry partners and avoiding resentment of other family members.

For a family transfer to succeed, it is important to establish clear expectations, provide leadership development opportunities, and create a formal transition plan well before ownership changes hands.

Turning Leaders into Owners.

A management buyout involves selling the company to key managers or executives who are already involved in operating the business. This form of succession planning allows for strong operational continuity because the existing managers understand the company’s projects, employees, customers, and culture, thereby reducing disruption during the transition. Additionally, an owner can utilize an MBO to incentivize, recognize, and reward the leadership team that contributed to the company’s current success and protect future income flow, as outlined below.

The potential disadvantages with MBOs include the following. Your skilled employees may not have the management experience or aptitude to handle the business side of the operation even though they have the skills to deliver the construction services. A qualified leader may lack the capital necessary to purchase the entity, creating a gap in the funding needed to purchase the company, requiring seller financing, bank financing, or other funding sources. Often this gap leads to internal buyers not competing financially with outside, strategic buyers resulting in a lower sale price for the owner. Finally, adequately structuring seller financing for an MBO can take years to complete successfully and add complexity to the transaction.

Some benefits of the MBO seller financing can be added capital gain tax savings as well as a long-term income stream as the seller moves into retirement. These transactions can also be structured to separate the operating company from the real estate and equipment, thus allowing the seller to continue to own these assets and lease or rent them to the employee buyers.

MBOs work best when the company has a strong leadership team, predictable cash flow, and excess capital to finance the transaction. MBOs are rarely successful in a distressed situation where the transaction must happen quickly and the business is not properly capitalized.

Building an Employee-Owned Future.

An employee stock ownership plan allows employees to acquire an ownership stake through a structure which forms a trust to raise funds to purchase and hold company stock on the employee's behalf, while the company continues to be managed by a qualified leadership group.

ESOPs offer several advantages for employees, including fostering engagement, loyalty, and a sense of shared purpose, while attracting and retaining skilled workers in a highly competitive labor market.

ESOPs also benefit the company and selling shareholders by offering potential tax advantages, the opportunity to begin complex estate planning, and raising more funds for expansion in certain verticals.

However, ESOPs are complex and expensive to structure and require specialized legal, financial, and administrative expertise resulting in continuing compliance costs. ESOPs also require consistent cash flow, which means they are not ideal for every company and generally work best for profitable, sizeable companies with steady revenue.

ESOPs are best suited for construction companies with strong employee cultures, long-term independence goals and larger clients. Unionized companies may be good candidates for an ESOP.

Maximizing Value and Liquidity.

A strategic sale involves selling the company to an outside buyer, such as another construction firm, private equity-backed entity, or an industry consolidator. Transitioning owners may prefer a strategic sale because they can often convert a significant portion of their business value into cash at the sale closing. Additionally, strategic buyers may pay a premium because they can benefit from geographic expansion, specialized capabilities, or access to customer relationships. A strategic sale also reduces an owner's risk by allowing them to diversify their wealth instead of keeping their net worth tied to the business.

Despite the advantages of a strategic sale, this form of succession planning results in a loss of control in which both ownership and decision-making authority are transferred to the buyer. The company employees may also face changes in company culture and management style, operating procedures, or may suffer from workforce reductions if the buyer restructures operations to improve efficiency. Customers will also need to be convinced that the new ownership is qualified to deliver the construction services they have come to expect.

Owners who seek the maximum value of their business or are interested in increasing their retirement liquidity may consider a strategic sale as the right choice. Further, sellers may initially value a quick and final sale, but others may wish to stay involved in the business and continue to add value to it through relationships and industry knowledge. This may lead to retaining some ownership of the company particularly if the strategic buyer has potential to increase the value of the company over time.

Choosing the Right Path.

As laid out above, there is not a one size fits all succession strategy for construction companies. The optimal solution depends on an owner's goals, financial needs, family circumstances, leadership bench strength, and vision for the company's future. Owners who prioritize legacy may favor family transfer or ESOP. Those seeking continuity and employee recognition may prefer a management buyout. Owners focused on maximizing value and liquidity often explore strategic sale opportunities. In many cases structure can be utilized in a combination that would allow each of these goals to be at least partially satisfied.

Start Earlier Than You Think.

Regardless of the path chosen, successful succession planning requires preparation. The most successful succession plans are not created months before retirement; successful plans are developed years in advance. Early planning gives owners more options, allows time to address potential obstacles, provides time to develop future leaders, and helps ensure a smooth transition for employees, customers, and stakeholders. Speaking with your trusted advisors can help you explore these options.

For construction company owners, succession planning is more than an exit strategy. It is the final phase of building a business designed to continue long after the owner steps away from the jobsite.

About the Authors

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