

# Cash Flow Management for Contractors

By Kellie Hanas, CPA

Cash flow management is difficult but essential and should not be overlooked. Contractors must ensure that there is always enough cash to allow the business to operate profitably and effectively. When your cash position is not monitored, there will be little or no time to react to a cash shortage.

The successful contractors that HBK works with understand, manage and project cash flow. The purpose of a cash flow projection is to determine the amount of cash necessary to handle the anticipated level of company operations and to determine when the cash will be needed. Each contract has its own cash flow cycle, i.e., there will be times when a contract will be a user of cash, at other times (particularly at the end of a profitable contract) it will be a provider of cash.

## Cash Flow Process

Projecting cash flow in the construction industry becomes more complex as the number of jobs increase. Preparing cash flow projections involves three phases: First, job operating schedules must be prepared for each contract. Second, based upon the job operating schedules a cash flow for all current and expected contracts should be prepared. Third, a company-wide cash flow projection which summarizes the cash flow for all jobs, should be prepared. This company-wide cash flow projection should include anticipated selling, general, administrative and financing costs for the company.

Completing cash flow projections is not an event but rather a process. It must be updated to account for new jobs, completed jobs and change orders. Projections may be based on weekly or monthly estimations, depending on various factors related to the construction company. Most projections look forward three months but we have seen longer and shorter time frames.

## Improving Cash Flow

One way to extend cash outlays is to negotiate with vendors on materials and supplies. If you can get extended terms (30-45 days), you can reduce potential negative cash flows.

Another option is to use subcontractors instead of trade personnel and subject them to the same payments terms you may be under with the general contractor or the ultimate owner. Thus instead of paying employees every week or every two weeks, you pay the subcontractor within thirty days of the submission of the invoice.

If using subcontractors you should verify their quality, safety, performance, timeliness and financial stability. If the subcontractor does not have good ratings in these areas it could negatively impact your cash flow process as they may not have the resources to complete their work or deliver their materials.

There is more to successful cash flow management than billing promptly and holding onto cash for as long as vendors will allow. Companies should develop internal business practices and cultivate strong relationships with their business partners. Consider having your financial personnel (internal or external) review the contract before signing to ensure you understand the anticipated cash flow of the contracts and requirements and timeline of submitting invoices.

During the bidding process someone should perform credit checks on the customer to support that the customer has the ability to pay. Consideration should be given to negotiating retention requirements and payment terms. Timely close out of projects will free up retention receivables sooner.

Another source of cash is to borrow from life insurance policies, if available. Also, consider renting/leasing equipment versus purchasing equipment needed.

## **Using the Information**

By using the information from your cash flow projections and implementing techniques to improve cash flow you will be able to avoid any surprises. If your company is unaware and has not planned to obtain additional credit, trouble could lay ahead. By reviewing the above information on a proactive basis, you will know when draws on your line of credit will be needed and you should be able to project when you will be able to repay your line of credit. .

## **Conclusion**

Cash flow projections can be very revealing. A company's most profitable period may also be the period of greatest cash flow needs. A well defined process relative to cash flow management will help position your company to continue to grow. In addition it will provide your banker and surety with the confidence that you are prepared to deal with the challenges of the cyclical nature of the construction business.

It is crucial that businesses fully understand their cash needs **in advance** and make adjustments to their operations to ensure that cash is available. The professionals at HBK would be more than happy to assist you in this process. Please call if we can be of assistance.

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