

Fine-tuning finances



Tips & techniques to maximize cash flow

There has never been a better time to find new ways to increase your bottom line.

BY AARON T. COOK

Most contractors understand and emphasize the importance of maximizing cash flow; nonetheless, very few contractors have implemented the necessary processes to do so. Whether a contractor requires additional working capital to expand operations or is simply trying to manage in the current economic environment, it is imperative that formalized processes are maintained to optimize cash flow.

For instance, as part of the project selection process and before submitting a bid or estimate, a standard form or checklist should include the contemplation of cash flow. Consideration should be given to the credit quality of the project owner and the prime contractor, as well as the source of project funding. Any past experiences should also be considered. For example:

- Did you experience inadequate project drawings or unclear project specifications?
- Were there excessive inspections and/or back charges?
- Did you receive timely payment?
- Were there disputes on change order pricing or even claims?

All of the factors above can significantly delay payment and will have a significant negative impact on cash flow.

After you have determined to pursue a project, there are several cash flow techniques that can be utilized during the estimating and bidding process. For example, cash flow can be accelerated by providing for additional cost and profit during the beginning phases of a project. This strategy is known as “uneven bidding” and is common practice in the construction industry.

Moreover, as part of the estimating and bidding process, a contractor should perform a cash flow forecast at the project level. This forecast should be routinely updated and incorporated into a company-wide twelve-month rolling cash flow forecast. This will allow for the identification of any cash shortages in time for corrective action. Although this may

seem like a basic financial management tool, many contractors do not prepare a rolling cash flow forecast.

Once the project has been awarded, it is essential to negotiate terms that favor positive cash flow. For instance, wherever possible, attempt to negotiate that no retention be withheld from progress payments or attempt to furnish a letter of credit in lieu of retention. At a minimum, the retention rate should be reduced based on percentage-of-completion or as project milestones are achieved. For example, a 10% retention rate should be reduced to 5% when the project is 50% complete and perhaps down to 2% at 80% complete. If retention is required, be sure to withhold the same retention rate from any subcontractors.

In addition, attempt to negotiate the right to bill pre-contract costs, such as mobilization and any bond or subcontractor default insurance premiums as an advance payment or as part of the first progress billing. Also, make an effort to negotiate for the payment of stored materials in advance of installation.

It is also important to obtain a thorough understanding of how progress payments will be measured. For example, will progress payments be based on the completion of project milestones, the overall percentage-of-completion, costs incurred plus a fee, an engineer's estimate, or units installed?

Once the contract terms have been agreed to, it is just as important that the appropriate personnel fully understand the billing and payment terms. For instance, will an AIA application for payment and schedule of values be required? What, if any, additional information must accompany the progress bill? This might include certified payroll reports, workforce compliance information, employee timesheets, daily job site logs, subcontractor and vendor invoices, material receiving reports, and first- and second-tier lien waivers.

By providing progress billings in the correct amount, format, and with the appropriate supplementary information, a contractor can prevent payment delays and consequently increase cash flow.

A contractor also needs to understand the contract terms that allow the project owner to delay payment. For example, will payment be delayed for non-confirming work, project delays beyond the contractor's control, claims, liens, non-payment of lower tier subcontractors and/or suppliers, or during any dispute resolution proceedings? Also, a contractor should be mindful of any pay-when-paid or pay-if-paid clauses. By knowing these unique contract terms, every effort can be made to avoid these pitfalls and prevent payment delays.

There are other simple, yet effective, techniques to prevent

payment delay. For instance, a contractor should know each individual who reviews and approves contract billings. A strong working relationship and an open line of communication should be developed with this individual. Furthermore, consider calling or even visiting this individual after the first progress billing is submitted to ensure that all contractual billing requirements have been met. Subsequently, call at least one week before payment is due to ensure everything is in order and that payment is scheduled as planned.

All of these factors should be contemplated and documented in a standardized form and all appropriate personnel should be privy to this information.

A contractor can also maximize its cash flow, as well as company profit, by incorporating sound treasury management practices. For instance, any excess funds should first be applied toward any outstanding line-of-credit borrowings. Generally, the interest rate on a line-of-credit will far exceed the potential earnings from short-term investments. To ease administrative burden, establish this as an automated process with your financial institution. If there are no outstanding borrowings, excess funds should be maintained in an interest-bearing account. Again, establish this process with your financial institution by maintaining 'zero-balance' disbursement accounts.

Additional treasury management techniques include establishing a deposit lockbox with your financial institution or taking advantage of remote electronic deposit technology. Both of these processes will expedite the deposit of funds and therefore will enhance cash flow.

Furthermore, discuss with your financial institution the availability of 'positive pay' or similar programs. These programs provide your financial institution with cash disbursement information in order to help prevent fraudulent misappropriation of assets.

By utilizing these tips and techniques, contractors can significantly increase their cash flow and profitability, while at the same time mitigating the risk of cash flow shortages. **BXM**



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