

## Surviving The Recovery When Business Picks Up, Cash Flow is Critical

The timing and pace of economic recovery is still far from clear, but there are signs of cautious optimism.

Ironically, this early stage of recovery can be the most perilous for a contractor.

After a prolonged downturn, it's natural to be eager to put crews back to work. Unfortunately, this can lead contractors who are already stretched financially to overextend themselves or take on risks they would normally avoid.

### Preparing For Expansion

As you gear up for greater volume, cash flow management — especially the prudent management of project start-up costs — is critical. In principle, there are two ways to approach this task:

- Make an accurate forecast of your backlog. Then estimate the cash you will need to successfully manage the volume of work.
- Determine your available cash and credit capabilities. Then estimate the volume of work you can safely handle.

In practice, of course, the process is more complex than this, and your approach will blend these two models. Ongoing changes in both backlog and your finances mean revisiting assumptions and estimates repeatedly.

In preparing cost forecasts, general contractors should pay special attention to those critical expenses that are not tied to “pay when paid” clauses that cause subcontractors to share some of the risk. Such costs include direct labor and burden, equipment costs, fuel, supplies and, depending on the contract, some project materials.

The goal is a reliable and realistic forecast of upcoming cash requirements and revenue projections for the coming year or more. Don't let enthusiasm influence your judgment or lead you to assume everything will work perfectly. If you do, even a slight payment delay on one major project could lead to collapse.

### Maximizing Cash Flow

In addition to accurate forecasting, successful cash flow management also calls for other best practices, including prudently choosing which jobs to bid.

One of the most dangerous mistakes an eager contractor can make is to take on a project without ensuring that funding is in place. Contractors who fail to verify project financing can find themselves waiting for months for payment as they act as de facto interim financiers, a role few contractors can afford to take on.

In addition to confirming financing, here are other steps that will help you manage cash flow:

- **Get off to the right start.** A good preliminary meeting with the owner or developer and the lender's representative can help prevent cash flow problems. Discuss in detail how you will be paid and what documentation will be required. Subcontractors should conduct a similar meeting with the general contractor.
- **Be prepared to negotiate.** Some lenders, sureties and owners are willing to negotiate certain issues such as the amount of retainage or lender set-asides. Don't be afraid to ask for an exception to standard practice.
- **Always invoice promptly.** Pay attention to the monthly billing cycle of your payment source. Missing a cut-off date by just one day could cause a 15- to 30-day delay in payment.
- **Manage change orders aggressively.** Contractors must be constantly alert to requests that are outside the original scope of work, and should process every change order promptly. Waiting until the end of the project greatly reduces your leverage.
- **Follow collections closely and protect your lien rights.** The deadline for filing a contractor's lien is set by statute. If you miss it, you no longer have a valid claim. Track pending invoices carefully and, to avoid misunderstandings, alert the owners in advance that you file liens automatically whenever a deadline approaches.
- **Stay informed.** Contractors should pay attention to the status of other projects the owner or developer is building, and subcontractors should stay alert to the contractor's standing among the other trades. These can provide valuable early warning of a potential problem.

\*\*\*\*\*

*The Construction Advisor* is produced quarterly by Bober Markey Fedorovich. For more information about our services, please call or email our team leader Dale A. Ruther, CPA, CIT, partner, at (330) 762-9785 or [druther@bobermarkey.com](mailto:druther@bobermarkey.com).

*Unless expressly stated otherwise, any U.S. tax advice contained in this communication (including attachments) is not intended or written to be used, and cannot be used, by the recipient for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.*

© 2010 Bober, Markey, Fedorovich & Company