Best Practices Guide:

FREEING CASH FLOW TO GROW YOUR CONSTRUCTION BUSINESS

VIEWPOINT CONSTRUCTION SOFTWARE®

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The phrase "cash is king" is nowhere truer than it is in a construction company. Excellent cash flow management always has been critical to success in construction, but since the "Great Recession" it has become a requisite for survival.

And while construction revenue has picked up since then, cash flow management remains problematic for the industry. Recent research finds that construction companies' free cash margin declined to 0.02% in the third quarter of 2013, compared with 4.68% for all industries[1] — the third consecutive quarterly decline for construction. Construction industry executives will no doubt be familiar with the underlying reasons cited for the decline: receivables days are on the rise while payables days are falling.

"The keys to shortening your 'time to cash' are standardized, repeatable business processes and strong information visibility, especially between project management and finance," explains Jay Haladay, CEO of Viewpoint Construction Software, a recognized leader in meeting the collaborative and information needs of the industry offering construction-specific solutions. Haladay's opinion echoes that of the construction business professionals interviewed for this best practice guide.

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> ***Jay Haladay, CEO***
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One Eye On Today, One On The Horizon

The firms with the best cash flow practices have several things in common. For starters, they're extremely proactive — many bill early and often — and they "overshare" information within their organizations, especially between project management and accounting/finance. Examples include one company that streamlined 30 days out of its job-close-to-payment cycle, and another that now asks customers to sign change orders on an iPad, at the job site, at the very moment they're ordered.

The interviewees forecast cash flow expectations months in advance, taking into account their new-business pipeline. They're keenly aware of the many different cycles that impact their cash flow (e.g., billing, seasonal, macroeconomic). They maintain reasonable cash reserves. They investigate the credit worthiness of prospective customers. And they have a line of credit to get them through the worst times … but they try their best to avoid using it.

Haladay explains, "It's all about planning, documenting project work and sharing that information with finance, and looking far enough ahead to account for market trends. If it looks like all you need is a short-term fix, many firms ask suppliers to stretch payments. If it's a longer-term issue, the well-managed firms have reserves to tap."

[1] Cash Flow Trends and Their Fundamental Drivers: Comprehensive Review (Quarter 3, 2013), Georgia Tech Financial Analysis Lab.

Best Practice Advice

Here are six points of more detailed, practical advice, compiled from interviews with construction business professionals.

1 **‘Overshare’ information!**

Visibility of information between project management and finance is critical. If your information from the field is not accurate, managing cash flow becomes extraordinarily difficult. Make sure you get accurate, timely information from the field; compare it to your estimates to know whether costs are going over or under your plan; and compare that information to billing to know whether you are over- or under-billed.

At County Group Companies (CGC), New Castle, Delaware, CFO Joe Waninger says there is consistent weekly interaction between billing and project management, including weekly notification of what jobs are under-billed, and regular alerts from Viewpoint’s software on each job’s hourly progress toward completion. CGC even audits certain aspects of its own operations every month, to ensure that billing accurately matches time worked.

2 **Forecast, know your cycles … and be ready to *act!***

Unfortunately, the construction companies that rarely forecast their cash flow – smaller ones, below $25 million in annual sales – are the ones that can be most challenged when cash comes up short. When forecasting, contractors need to examine job progress and receivables, and anticipate spending on upcoming phases of all projects. They also must account for various cycles, with customer payment cycles first. Getting to know a customer’s payment cycle will help to bill for payment that’s in sync with the optimum day on that cycle, thus minimizing time to cash. Additionally, most regions of the US have annual construction business activity cycles that ebb and flow in alignment with weather patterns. And at CGC, Waninger has noticed an annual cycle in which customer payments almost completely dry up. “It seems like there is a cyclical slowdown from December to February, as everyone is closing their tax calendar year-end,” he notes.

Importantly, the best forecast is worthless unless the firm takes action based on it. That action may be as simple and problematic as stretching payments to suppliers. “Sometimes I have to stretch out payments to 90 days or longer, and that is upsetting to me. But I’m grateful that our best suppliers understand our annual cyclical issues, and work with us extremely well,” says Waninger. Other actions cited by interviewees include offering discounts for faster payment, selling idle equipment (mostly for heavy construction firms, which can have millions tied up in their gear), dipping into a line of credit, and reducing staff.

> ***“With iPads, a customer can sign with his finger right on the scope of work, so we can generate that invoice the same day, get it approved by the project manager, and sent.”***
>
> ***Joe Waninger, CFO***
> ***County Group Companies***

3 Bill early — and often.

You don't want to be under-billed (in which case you're financing the job for your customer) or over-billed (in which case you have more cash than you're due — and you'd better be careful about managing it because you're going to need it at the end of the job). "It's smart to bill a small amount as quickly as appropriate. That gives you the opportunity to learn your customer's billing cycle before large sums are at stake," says Dennis Sutton, formerly CFO at The Norwood Company, headquartered just outside Philadelphia, Pennsylvania, and now Senior Solutions Engineer at Viewpoint. Of course, billing depends on the information flow from the field, presented earlier. Software systems that track job activity every day are key, because they enable the option of billing based on percent of completion — and alert you the very moment that the next billing milestone is achieved.

After the Great Recession hit at Building Services Inc. in Milwaukee, Wisconsin, Executive VP/CIO Jim Macejkovic used technology to build automated, electronic processes that helped cut 30 days out of the firm's billing cycle. Before that, completed job files were written up once a week, and project managers' reviews of the final bills were all done on paper. "It used to take us up to three weeks before the customer was sent a bill, which resulted in a cash flow cycle of 95 days from job close to payment. Now we have a 65-day average turnaround time in cash flow — a full month's improvement!" explains Macejkovic.

At CGC, Waninger is experimenting with mobile devices to help bill faster. "We're testing mobile invoicing of change orders," says Waninger. "With iPads, a customer can sign with his finger right on the scope of work, so we can generate that invoice the same day, get it approved by the project manager, and sent."

4 Don't skimp on cash reserves.

The companies that have weathered challenging times best have significant cash reserves, and look at where their financials are every day. A recommended minimum is roughly 5 percent of annual revenue, though some companies' reserves are in the teens, and occasionally even upwards of 20 percent.

At Nevada Gypsum Floors, Inc., headquartered in Henderson, Nevada, CFO Joshua Ellison credits his firm's cash reserve as a primary key to the company's longevity over three decades. "Our cash reserve is one of the reasons we're always among the companies left standing when times get rough. We've had to use it two or three times in the 13 years I've been here. We were able to pull through and expand in the midst of the Great Recession because of our cash reserves." Viewpoint's Haladay adds, "Companies with strong cash reserves are just plain smart. It means in the good times they planned ahead and did not take all the assets out of the company."

> ***"Our cash reserve is one of the reasons we're always among the companies left standing. We were able to pull through the Great Recession without having to lay off any of our staff because of our cash reserves."***
>
> ***Joshua Ellison, CFO***
> ***Nevada Gypsum Floors, Inc.***

5 **Be vigilant — investigate potential customers' payment history and credit worthiness.**
Construction business professionals stress the importance of background checks on new customers. Though it may seem unlikely that you would turn away business, it's far worse to get deep into a job before learning that the customer may not have the wherewithal to pay it through to completion. In small communities, word-of-mouth reports from colleagues may be all you need. And just because a customer has had difficulty paying in the past doesn't mean you have to turn the business down. At CGC, such foreknowledge has enabled them to arrange up-front payments with certain customers; and they even accepted work from a customer that was under bankruptcy protection by involving an attorney to work out an arrangement that was acceptable to the customer and assured CGC of payment.

6 **Don't be afraid to use your lien rights.**
A lien is one of the few legal tools at a construction company's disposal to push slow-paying customers to pay faster — and it can be highly effective. "Just sending a notice of intent to lien can shake some money loose from a customer," says Nevada Gypsum Floors' Ellison. He adds that it can't be an empty threat: "You have to decide that you will, in fact, file the lien before you even send your notice of intent. We utilize our lien rights when a customer is non-responsive, dishonest, or has broken payment promises to us on more than one occasion."

Conclusion

These six cash flow best practices will strengthen any construction company that uses them. Remember to:

1. 'Overshare' information
2. Forecast and know your business cycles
3. Bill early – and often
4. Don't skimp on cash reserves
5. Investigate customers' payment and credit histories
6. Use your lien rights

If you do, you're certain to be among those construction companies "left standing" no matter which way the wind blows in the macro economy. It's valuable to employ contemporary construction technology, too, to speed and simplify the process for a true competitive edge.

Best Practices Guide Series

This article is part of Viewpoint's *Best Practices Guide* series, the aim of which is to provide straightforward, actionable, and detailed advice on the business and technology topics that are most important to construction firms. The advice is synthesized from conversations with leaders of construction firms of all sizes and in all industry segments.

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Executive VP/CIO
Building Services Inc.

ABOUT VIEWPOINT

Viewpoint, a leader in meeting the collaborative and information needs of the AEC industry offers construction-specific solutions for a variety of professionals including small, medium, large and enterprise contractors. Viewpoint solutions include takeoff and estimating, project management, accounting solutions, enterprise resource planning, project and BIM collaboration, mobile field-to-office and enterprise content management. Viewpoint customers include more than 30 percent of the ENR 400 and have the most technology partnerships with the top 50 mechanical and electrical contractors in the United States. Viewpoint serves as the technology partner of choice to the construction industry and delivers the right solutions on the right platform, including cloud, SaaS and on premise solutions and provides customers improved accountability, efficiency and productivity throughout the U.S., Canada, the United Kingdom, Europe, the Middle East and Australia.

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