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How to keep cash flowing from one project to the next

By Kim Slowey
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For many contractors, financing existing jobs while investing in new work is a big balancing act that forces them to constantly weigh one financial obligation — i.e. payroll, taxes, subcontractors, material suppliers — against another.

And the star of that act is cash.

"Contractors don't go out of business because they have lack of work or poor performance on their projects," said Carl Oliveri, partner and construction practice leader at New York City accounting and consulting firm Grassi & Co. "They go out of business because they have no cash."

Money problems can affect more than internal operations, said attorney and construction litigation expert Barry MacNaughton, managing partner at Ervin Cohen & Jessup LLP in Los Angeles. They can also negatively impact client relationships if they prevent a contractor from properly manning the job or result in mechanics liens because of unpaid bills.

Where's the cash?

And these cash flow issues, Oliveri said, usually come down to one or more of the following:

- Cash is tied up in projects, meaning it's being used to pay for job-related bills and expenses.
- Customers are slow to pay invoices.
- The contractor — general or sub — has submitted invoices that are not enough to cover the amount of work they executed.
- The contractor has performed and paid for changes that have not yet been approved by the client; therefore, they remain unbilled.
- There are missed deadlines or other billing missteps due to a new client's unfamiliar billing practices.
- There is an unexpected increase in operating liabilities like payroll taxes, union dues, insurance fees or other financial obligation.

Smaller companies, Oliveri said, are more likely not to follow through with the administrative procedures that can prevent some of these problems, such as billing frequently enough and on time. This is especially for the one- or two-person startup.

“The reason they're having success, that they're growing, is that they’re winning work,” he said. But, he added, they’re not thinking about the back-office infrastructure — hiring or training people to perform administrative functions — that they need to support that growth.

Fast growth, Oliveri said, can be devastating on cash flow anyway, and having the right supporting staff in place is key if the business is going to be successful.

Subcontractors are particularly susceptible to cash flow problems because, unlike many general contractors, they typically bear the burden of the project’s labor and material costs. If the owner slows down payment, both general contractors and subcontractors have to wait for their checks, but big payrolls and their related taxes, benefits and other expenses must be paid no matter what, said James Miller, partner and member of Marcum LLP’s national construction industry group.

And then there are change orders. "The biggest problem that we see with subcontractors,” Miller said, “is change order management and claim management.” Oftentimes, the general contractor or construction manager, he said, will put subcontractors on the spot and demand they make changes or do extra work on the fly, claiming that it’s necessary to keep the job moving. From a subcontractor’s standpoint, he added, this is always frustrating and makes it hard to run a business.

For this reason, MacNaughton said, it’s important for contractors to maintain written communications about changes — even from the field — as they go, rather than wait to work them out later.

One strategy, he said, is for subcontractors to send an email to the general contractor — or general contractor to the owner — documenting that the extra work is a change, along with the estimated cost and how much time it will add to the schedule. "At the very least,” he said, "the contractor needs to get its position in writing on contract changes in scope or time when those changes occur, even if the contractor elects to go forward and continue to work and resolve change orders at a later point in time.”

Showing up to regular jobsite meetings, Miller said, is also a way subcontractors can keep their fingers on the pulse of the project and learn about changes before they find themselves dealing with them in the field.

When it comes to billings in general, neither general contractors nor subcontractors should be afraid to ask their clients to sit down and make sure their invoices are correct, Oliveri said, even if that means going through a pay application line item by line item. It’s better to hammer out any differences before the invoice goes through processing, he said, rather than get a nasty surprise — less money than expected — on payday.

And on those billings, Oliveri said, it’s smart to “front load” when possible, which means assigning the highest values possible to the early phases of work and then invoicing for those items near the start of the job. This could help finance the rest of the project, Miller said, as long as contractors don’t use the money for things like bonuses but reserve those funds to finance new work or the cash demands of other jobs.

Another thing Oliveri said contractors can do to head off cash problems is to institute a policy of strict cash flow management and make sure staff in the office and the field follows it. “Let everyone in the organization know that we live and die by the dollar,” he said. Such a plan should focus on collecting outstanding receivables, limiting noncritical expenditures, slowing down disbursements when possible and using extra cash to reduce borrowing needs.

How to get out of trouble

Once a contractor is in trouble, there are still ways to help the situation. One option is to go the client and request an accelerated payment schedule, MacNaughton said. "Many owners and developers will work with contractors to speed up the payment process or directly purchase materials in order to help with a cash flow crunch," he said.

Bonding companies for both general contractors and subcontractors could also provide a solution in the form of a loan. "If you bring the bonding company into the mix early enough," Oliveri said, "they'll [advance] you the cash in some cases to get through the project because it's cheaper for them to back you than to find a replacement contractor."

In fact, earlier this month, when Magnum Construction Management (MCM), formerly known as Munilla Construction Management, the general contractor for the Florida International University bridge that collapsed last year, filed bankruptcy, its attorneys asked for permission to move forward with more than $18 million in financing commitments from its sureties so that it could complete bonded work.

It's also likely cheaper, Oliveri said, for contractors to approach the bonding company first when a job is in trouble. If the bonding company has to hire a replacement, he said, it is usually at a premium, an amount that the original contractor and its principals will end up owing the surety.

A bank loan is not out of the question either, Oliveri said, if the problem truly is cash flow and the project is still on target to make a profit.

The last resort, he said, should be what the industry calls "factoring," which involves selling company receivables to a third party. The lender typically keeps 15% or more of the invoice value, and, on a job where margins are tight, such a move could create even more cash flow problems.

Downsizing in areas that are not related to job production, taking on more work and cutting loose those who have been mismanaging their responsibilities are also some options that could help jumpstart a recovery, Miller said.

No matter the source of money problems, MacNaughton said, withholding that information from the customer is a big mistake. "The benefits of a contractor or subcontractor sharing potential problems with the client as soon as possible are that those problems tend to be resolved more quickly, less expensively and with a much better outcome," he said. "[No contractor] likes to have problems … sprung upon them at the last minute. Clients are no different."