ON-SITE

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Fighting back

Tough economy challenges contractors to control cash flow

By now, you've probably heard plenty about how tough the economy has been and, in many respects, continues to be. The construction business has hardly been spared, with most industry sectors projected to endure drops. (See "Futurescope: Construction Business Trends" on page 6.)

During times like this, it's easy to panic. But a better strategy is to fight back — figure out ways you can keep your company's head above water while maybe, just maybe, gaining an edge on the competition. To do so, you'll need to do one thing in particular: Control your cash flow.

Forecast your cash fortunes

One reason many construction companies get into trouble is a surprise attack of poor cash flow. To prevent this, perform a realistic cash flow projection to help you decide whether you can afford another project. Such a projection can also enable you to pinpoint precisely what type of job may be within the grasp of your current cash flow.

Cash flow surprises can often spring up from inventory or material purchases.

Generating such a projection involves looking at both the past and future. Examine your projects scheduled for the next year and delineate where you'll likely be spending money. Bearing in mind that things could change, lay out your expected cash flow needs, by month, for each job. Don't overlook your expected nonjob outlays, such as overhead, materials, labor, subcontracts and permits.

In addition, remember that working capital needed for a job depends, in part, on the project's costs. For example, you generally need to pay labor and equipment costs currently, which is often *before* you get paid. Meanwhile, materials and subcontractor costs often don't need to be paid until the company collects from the general contractor or owner.

Next, examine your expected monthly revenue. In cases where you're doing a job for a new owner or planning a project on spec, you may encounter difficulties predicting the timing. But you can use your historical payment data to calculate an average for planning purposes. This same data, accumulated over time, also can give you an idea of how quickly certain owners pay their bills.

Ultimately, a properly completed cash flow projection should enable you to see when and where you might run low on cash in the upcoming year. Your CPA can help you with the exact calculations.

Revisit project management

There are many aspects of a project that can hurt your cash flow — or help it. Take change orders. If you devise a better system for getting them approved, you'll get paid more quickly for them and drive more money to the bottom line.

Try to get a feel during contract negotiations as to how change orders will be handled. Also look into increasing your margins on change orders to compensate for your cash outlays.

There's also the issue of billing. You obviously don't want to underbill, but overbilling for best cash flow results can be key. Doing so requires discipline and strong cash management skills. You need to allocate dollars properly, and you aren't likely to accomplish this by looking only at your bank account balance.

Above all, ensure your billing and collection procedures are as fast and efficient as possible. Establish strong follow-up procedures for handling slow payors. You may need to be more aggressive in collecting your receivables.

Review inventory, purchasing

Cash flow surprises can often spring up from inventory or material purchases. Although this may seem like the worst time to acquire debt, it's often unavoidable if you have to procure long-term assets, such as heavy equipment. Nonetheless, it's generally preferable to pay for items you're going to own for an extended period over that very period and save your cash for other, more immediate purposes.

Also keep an eye on inventory. Keeping materials on hand may keep jobs running smoothly, but buying too much can hurt your cash flow. Plan your orders so you can keep your inventory as close to zero as possible without jeopardizing project timeliness.

Now is also a good time to review your vendors. Are you getting the best terms possible? Could you perhaps negotiate a discount with any long-term suppliers?

Respect the power

We'll spare you the clichés about the importance of cash. Its regality was established long ago. But in times when the economy makes running a difficult business all the more difficult, respecting the power of cash is essential.

Another tough times strategy: Diversification

If your construction company specialty is hotly contested in your market, maybe it's time to sidestep the fray and move in a different direction. One way to bring in more cash is to create a new revenue stream by diversifying into other areas.

Diversification can mean many things. For some contractors, it's as simple as offering additional services — such as building or maintenance work. For others, it could be bolder moves, such as a home builder moving toward the commercial side (or vice versa).

In still other cases, a construction company may acquire another business to diversify. For instance, an HVAC contractor that buys a sheet metal shop probably has effectively diversified within its specialty.

Naturally, there are risks to diversification. Different specialties require different materials, vendors, building techniques and licensing requirements. There will likely be a learning curve involved and, if not anticipated properly, that learning curve could deplete much of the revenue you'd hoped to gain.

Mobile computing devices demand top-notch security

Whether they use a smart phone, PDA, tablet computer, or full-blown laptop, mobile computing devices have become constant companions to most contractors. From a productivity standpoint, this is good news. So many tasks that once kept you tied to your desk are now doable from the remotest parts of a job site, your vehicle or a booth at your favorite restaurant. All this convenience, however, isn't without risk.

A scary new world

Perhaps the most obvious danger of owning a mobile device is that it could be stolen, which could end a workday early and lead to considerable replacement hassles. Indeed, given the current economy, thieves may be increasing their efforts to snatch easy-to-grab items such as PDAs and vehicle-based GPS systems. Theft insurance is highly recommended.

Of course, the risks only get worse from there. A stolen or hacked mobile device means thieves and hackers can gain possession of sensitive, confidential information about you and your construction company (clients, jobs, employees and finances).

Amateur criminals might look for credit card numbers, but more sophisticated ones can find uses for bidding data, project estimates and construction plans. Custom blueprints, for instance, can be particularly valuable.

5 key protective measures

Fortunately, there are a variety of ways to keep your mobile computing devices safe. Here are five key protective measures to consider:

1. Standardize, standardize, standardize. Having a wide variety of mobile devices increases your risk. Moving toward a standard product (such as a Blackberry or particular model of tablet PC) and operating system will allow you to address security issues across the board rather than dealing with multiple makes and their varying security challenges.

2. Password protect. Make sure that all your employees are using "power-on" passwords — those that

appear whenever a unit is turned on or comes out of sleep mode. In addition, set up all mobile devices to require a power-on password after 15 minutes of inactivity and to block access after a specified number of unsuccessful log-in attempts.

3. Set data storage limits. Don't allow employees to store certain information, such as Social Security numbers, on their portable devices. If sensitive data must be transported, "encrypt" (make it unreadable using a special code) the unit's data.

4. Keep it strictly business. Everyone has a tendency to mix personal information with business data on portable devices. Issue a company policy forbidding this dangerous practice. Moreover, establish limits on what networks or information users may access.

5. Fortify your defenses. An unprotected mobile device is an accident waiting to happen. Be sure that yours have firewalls installed to help prevent unauthorized access, block spyware/adware programs and stop viruses. You might even consider installing "bombs" on the device that wipe a unit's memory clean if stolen (rather than lost).

Not just another asset

You work hard to protect the assets you deploy on your job sites — from small tools to heavy equipment. Well, mobile computing devices are key assets, too. But they're not like all the rest, because the data they hold can be just as valuable, if not more so, than the unit itself. Make sure yours are safe.

Business improvement strategies

Benchmarking helps answer the tough questions

How are you? It's a question we ask each other all the time. But how often do you ask it about your construction business? Sure, you could look at your project log to see how many jobs you've got in the pipeline. Or you could take a glance at the bottom line of your latest financial statement.

Yet you won't really know how your company is doing unless you ask some tough questions. And one of the best ways to do so is to undergo a process called "benchmarking."

Why do it?

The nuts and bolts of benchmarking are fairly simple: You choose common functions and practices of your construction company (often called "metrics") and compare them with either your company's past results or those of similar businesses.

One advantage to benchmarking financial metrics is that an abundance of data is available.

As you might imagine, many contractors opt for the latter choice: putting their metrics up against those of competitors (or at least companies similar to their competitors). So-called "competitive benchmarking" tells you not only how you're doing in key areas, but also what you may need to do to maintain (or regain) your competitive edge.

A good place to start competitive benchmarking is by communicating with other contractors, who perform work similar to yours, in outside markets. A national or regional builder's association meeting may provide the opportunity to discuss best practices and key metrics with your peers.

Another, more "data-based" way to get started is to join a trade organization that conducts annual financial surveys. Examples include:

- The Construction Financial Management Association (cfma.org),
- Associated General Contractors of America (agc.org), and
- The Construction Industry Institute (construction-institute.org).

You might also work directly with a construction consultant who has access to a large database of contractor data.

What should you measure?

As mentioned, benchmarking is based on metrics — how your construction company performed in key functional areas of your choosing.

For example, many contractors look at job costs. You might compare your initial project estimates with the actual costs of jobs you've completed. You could also compare overbillings and underbillings with volume. Or another option is to compare cash flow with gross margins. One advantage to benchmarking financial metrics is that an abundance of data is available.

Dollars and cents aside, timeliness and efficiency are also critical in a construction business. You might benchmark your capacity for keeping jobs on schedule by looking at how many days you expected to spend on projects vs. what you actually spent. And then ask: Are other, similar companies working faster (and, thus, more profitably)?

You may also want to benchmark your safety record. As you well know, job-site accidents can devastate your bottom line. You might examine the number of incidents and calculate the number of lost workdays as a percentage of total hours worked, and then compare this figure to other companies' results.

What could go wrong?

Benchmarking does have its risks. For starters, beware of *national* benchmarking. Although informative, data culled from nationwide surveys and studies may be misleading or inapplicable because construction practices vary widely across the country.

In addition, you'll likely be gathering a substantial amount of data; if it's not formatted properly, you could find yourself overwhelmed and unable to put it to good use. Your best bet is to design a spreadsheet that lists your company's jobs throughout the year and displays columns for each benchmark. (Ask your CPA for help with this task.)

Last, there's always a risk of simply doing nothing with the information you gather. Be sure to devise a formal strategy for converting benchmarking data into actionable steps. Put follow-up meetings in your schedule and be prepared to find (or appoint) champions for each metric in need of improvement.

Is that all?

Remember, you can benchmark just about anything that can be observed or measured. Focus on metrics that are critical to your construction company's success and make benchmarking an annual tradition.

Futurescope: *Construction Business Trends*

3 hot construction areas in a chilly economy

What does 2009 hold for contractors? Well, if you're like most contractors, you probably suspect that this year won't be easy. Indeed, there are few, if any, major project types that will stand out as hot options in this chilly economy.

Late last year, Associated Builders and Contractors (ABC) released its 2009 economic outlook, which confirmed the economic cold front settling over the nation. It forecasted declines in commercial building, lodging, office construction, manufacturing and industrial construction. A separate report released by credit market research firm Fitch Ratings projected, not surprisingly, that the residential building market would also remain slow.

Yet despite these gloomy forecasts, a few bright spots may break through. Three distinct possibilities are:

1. Green building. As public awareness of the environment remains strong, and the costs of energy-*un*friendly homes and buildings become more acute, the demand for sustainable building practices will continue to rise. (The one area in which ABC does foresee growth this year is alternative energy–related power construction.) Construction companies capable of building, upgrading and rehabbing structures using green materials and techniques stand to gain a competitive edge over slower-to-adapt contractors.

2. Federal infrastructure projects. The American Recovery and Reinvestment Act of 2009, signed into law Feb. 17, includes a wide variety of infrastructure improvement initiatives, appropriating billions of dollars for construction projects. If there was ever a time to try your hand at a government job, this may be it.

3. Smaller houses. Real estate information site Zillow.com recently reported that smaller houses have been showing a greater rate of appreciation — 5.2% — when compared with larger houses (those measuring over 3,000 square feet) — 3.5%. Although housing markets differ from region to region, this could indicate that developers may be looking to build houses with reduced square footage. Smaller houses also play well to the buying public's environmental concerns as well as to retirees seeking safer living spaces.

At the end of the day, your local market will determine what project types will present themselves as viable in 2009. But looking for breaks in the clouds may shed some light on how your construction company can stay competitive.

The Contractor's Corner

What are the risks of taking on an out-of-state job?

For the first several years of its existence, my construction company did perfectly fine in our local area. But jobs have been getting increasingly hard to come by and, once we finish a major project we're currently working on, we could face an almost complete shutdown.

I know there may be opportunities arising in neighboring states. I'm a little wary of bidding on these projects, though. What risks would I face if I did?

Indeed, crossing state lines involves far more than simply loading up your gear and a work crew and showing up at the job site as usual. Now, that doesn't mean you shouldn't consider these projects; but you'd be wise to identify as many of the risks as possible ahead of time.

Taxes and licensing

To get a better idea of just how much (or whether) an out-of-state job could be profitable, first look into the project's tax impact. A state will be able to tax your job revenues if you establish "nexus," which is defined on a state-by-state basis but, generally, is triggered by minimal business activity.

How and how much you'll be taxed depends on your business structure and the particular state's tax rates. A few states have no income taxes, some have relatively low rates and still others have relatively high ones. Those that do tax may lay claim to a percentage of your income, capital or gross receipts.

On the bright side, check to see whether you might qualify for state-specific tax incentives, exemptions or credits. For instance, environmentally friendly jobs are increasingly eligible for tax breaks.

In addition to taxes, licensing is also an important issue. Ask authorities at both the state and local levels about the permit and licensing procedures you'll need to follow. Some states may require some office personnel (such as project managers and the controller) to take licensing tests.

Labor and materials

Once you win a bid, you're going to need to move people and equipment into the area. Regarding the latter, determine exactly how and where you can safely store your gear and materials. Because you may need to work with local suppliers, look up their credit reports and, if possible, ask some "native" contractors which vendors they work with and whom you can trust.

When it comes to your crews, certain challenges could present themselves. Nonunion shops often bring along their own work crews. But don't underestimate the value of local help when assembling your out-of-state workforce.

For union shops, prejob communication is key. Strongly consider dispatching a project manager or foreman to the local hall to meet area leaders and workers. The quality of laborers you receive will largely depend on establishing good relationships. Inquire as to whether a native foreman can help manage the project.

Only the beginning

Of course, the risks we've touched on here are only the beginning of the challenges you may face by accepting an out-of-state job. For example, you'll need to consider legal liability, as rules governing workers' compensation, key contract provisions and insurance may all differ across the border. Learn as much as you can before you hit the road.