Does Cash Flow Management Affect Your Surety Credit? You Bet It Does!

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Cash is the ultimate measure of your company's value. All other items on your balance sheet are purely timing issues waiting to affect your cash balance. A proper cash management strategy can allow you to generate income from excess cash, or plan for times when outside funds may be necessary to cover temporary cash shortfalls.

Whether you are expanding your business or trying to maximize profits, understanding how and when the timing of cash inflows and outflows occur is essential to properly managing your company. As economic times tighten, a contractor's surety, lender, and other credit partners can extend more preferable terms and conditions if a strong cash management strategy is being employed.

The basis of a strong cash flow strategy is a clear understanding of when cash comes into your business versus when it needs to go out. Without understanding the timing of your cash needs (expenditures and debts) versus intake (cash sales, account receivable collection, interest, investment income), your company can be vulnerable to a dangerous cash flow position that ultimately could lead to its demise.

Develop a Strategy

Whether you are a public works, commercial, or residential contractor, a general or subcontractor, there are several questions you should ask that will lead to steps you can take to maximize your cash flow and develop a stronger cash management strategy:

1. Are you aggressively collecting your receivables from owners and/or general contractors while negotiating favorable payment terms with your subcontractors and/or suppliers? By increasing your float, your company can earn interest on "borrowed" money. Are you taking advantage of supplier discounts?

2. Do you have someone responsible for account receivable collections, or are you trying to take on too many responsibilities? If you are responsible for project management and/or overall business operations, you probably don't have the time needed to aggressively pursue receivable collections. If you are not collecting your money as soon as possible, you are essentially throwing away income via investment opportunities or interest income.

3. Are you diligent about including all necessary paperwork with billings? There are some owners and general contractors that will use any reason available to delay payment to you. Why give them a reason to hold your money?

4. If you have excess cash above and beyond what you need for routine expenses and debts, are you investing those funds? While both short term and long term investment vehicles

are available, you need to balance your investment decisions with your cash flow projection to know when or if those excess funds may be necessary. Proper investments can lead to additional income for your company.

5. How's your bank line of credit? While no one wants you to use your line and generate interest bearing debt, it is important to have an adequate line available to meet short term cash flow deficiencies and/or unexpected needs. The general rule of thumb from a surety perspective is to maintain a bank line of credit equal to ten percent of the largest project you will pursue.

6. Do you use zero balance accounts or sweep accounts? Many banks and financial service firms have these services available for your use. Not only can they simplify your business, they also place excess funds in the highest interest bearing account available.

7. Do you have current cash flow reports that are prepared on a regular and timely basis? Have you received input on the format and contents of these reports from your surety and lender?

A cash flow forecast or budget can be prepared for any period of time or when a stretch in credit capacity is needed. At a minimum, a one-year budget matching the fiscal year of the contractor is recommended. The projected cash flow should be prepared on a monthly basis for the next year, and revised at least quarterly to reflect actual performance in the preceding three months of operation as well as to check its projections. While long term projections are difficult, as contractors are continuously acquiring new work, quarterly — or even monthly revisions that include the new work acquired — will help fine tune your projections.

Forecasting Your Cash Flow

A cash flow forecast used as a business budget allows the contractor to anticipate problems rather than react to them after they occur. It permits comparison of actual receipts and disbursements against projections to identify errors in the forecast. If cash flow is analyzed monthly, a contractor can correct the cause of errors before it harms profitability.

A complete cash flow projection should include a narrative of cash flow assumptions and a number of various schedules. Useful schedules include a Completion of Work on Hand Summary, Cash Flow Analysis, Progress Payment, Retention Receivables, and a Time-Line Run-off schedule.

By closely watching the timing of cash receipts and disbursements, cash balances on hand and loan balances, a company's management can readily identify such things as deficiencies in collection of receivables, unrealistic trade credit, or long repayment schedules. In short, a strong cash flow strategy is the most valuable tool management has at its disposal to refine the day-to-day operations of a business. It is an important financial tool that surety and bank lenders use to evaluate when it is justified to increase credit capacity, for it demonstrates not only how large the credit extension can be supported, but also when and how the credit will be run off or repaid.

Cash flow issues are critical to any contractor's current and future success. Poor cash flow planning can lead to unhappy creditors, frustrated subcontractors, disappointed clients and even going out of business. Do you always have the right amount of cash on hand? Do you know when you'll need more? How will a new job impact the cash needs of your current work program? Are you really as profitable as you think you are? All of these issues are critical to your company's future profitability and viability. How is your cash management strategy working for you?✷