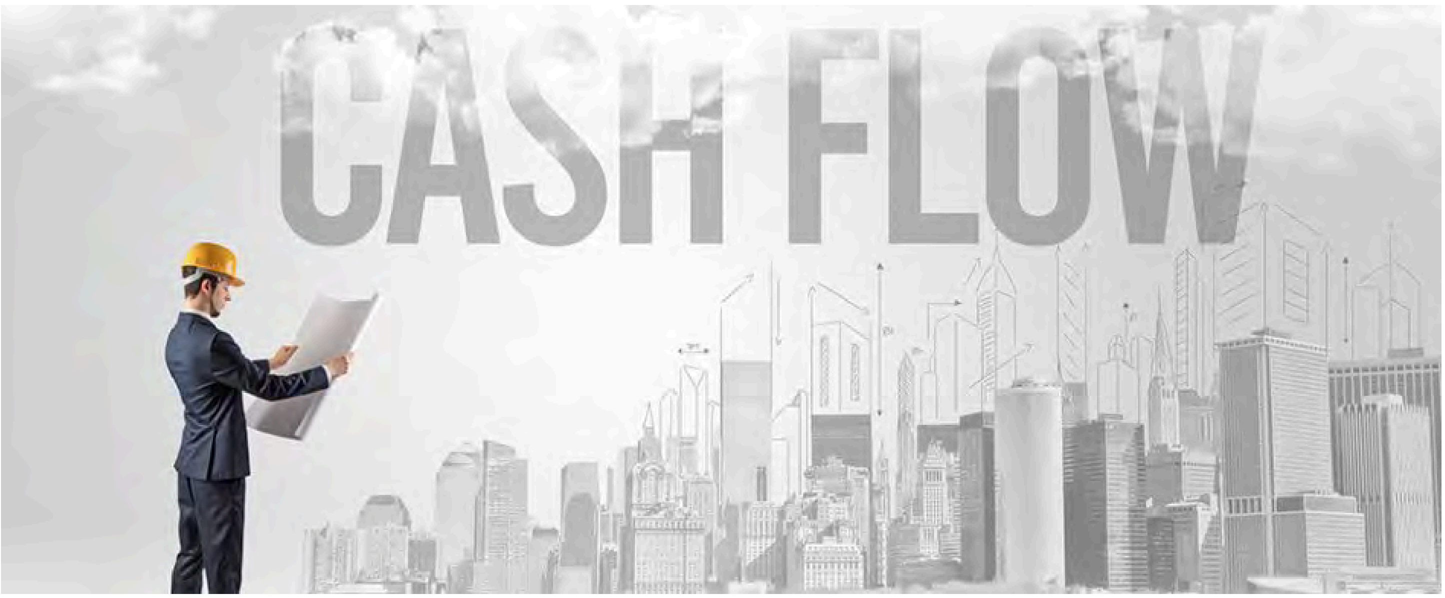
4 Key Areas for Optimal Cash Flow Management



Financial practices that can help your business overcome economic challenges

by Marty McCarthy

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As the construction industry transitions into the new year, it finds itself in a similar position to someone adjusting to a new day after a long night — the once buoyant stimulus era, characterized by the Paycheck Protection Program (PPP) and Employee Retention Credit (ERC), has dimmed, leaving behind a commercial sector grappling with uncertainty and a residential sector tightening its financial belt. Now facing the dual pressures of inflation and rising interest rates, the industry must also contend with labor issues that continue to constrict profit margins.

In this ultra-competitive environment, the industry must take a page out of the tried-and-true playbook favored by virtually every business facing macroeconomic challenges. To that end, it's a good time for construction businesses to refocus their attention on one aspect of their business they can control: cash flow management.

Here are four of the most effective steps your construction business can take to maximize available financial resources. Embracing these practices could make the difference between riding the current economic wave or being engulfed by it.

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1. Contracts

Review and enforce the collections and receivables clauses within your contracts to ensure that you are collecting and paying in compliance with the terms you've established. Hopefully, those terms were written to provide some degree of cash flow protection in challenging moments like the present.

Pay your payables in accordance with contractual terms and conditions, and make sure to review your agreements with subcontractors for applicable "if paid" and "when paid" language. Clauses like these may not always be strictly enforced, particularly in the relatively good economic conditions of the past few years, so it's wise to review each contract now as if it's the first time you're seeing its language. Stricter adherence to your contract terms may help you get a handle on any issues adversely impacting your cash availability, which, in turn, impacts your ability to borrow.

If you find that, upon closer review, your contracts don't include clauses built in as safeguards protecting cash flow, recognize the mistake and avoid it in the future by always using proper, up-to-date language that can be helpful in the event of another downturn.

2. Credit

Individuals in financial distress are often advised to pay off interest-accruing loans as early as possible, and it's just as smart for businesses to do the same. If your contracting firm is paying variable interest on any loans in this high-interest rate environment, it should be a new high priority to get those loans paid off as soon as possible. The cost of funds has a significant impact on cash flow, and how your business manages credit is worth an in-depth review. However, the top-down, more thorough assessment can wait. For now, the priority should be paying off any current loans siphoning cash. As tempting as it might be to simply service your debt and use any remaining cash to invest elsewhere, there's only one good way to get out from under a loan liability — and that's to pay it off.

Some smart businesses have adopted weekly credit payment practices, paying off interest-accruing expenses every Friday. It may not seem like a lot at first glance, but with 52 weeks in a year, Saturdays and Sundays end up accounting for more interest expenses than you might realize.

3. Eliminate Expenses

It's the unfortunate — but not entirely untrue — stereotype of consultants that workforce reduction is always the first recommendation when it comes to eliminating expenses. However, human resources are not the only expenses a business takes on. In fact, construction businesses may be better prepared than others to cut overhead in other ways. Start by looking into your insurance coverage: Are you paying liability coverage for certain specialized contracts that are no longer active? Any form of coverage in excess of what is strictly necessary can likely be phased out for an easy way to boost cash flow.

Next, look at your real estate footprint. Many contractors took on warehouses when pandemic concerns exposed the faults in just-in-time shipping. What may have been a smart move at the time could look more like a liability in 2024. Of course, shipping in certain global regions is facing new challenges, so determining whether an expense is necessary requires constant calculation and recalculation. If you're not already familiar with your supply chain, take a closer look at where you're sourcing materials and components from, and how much stock you have or desire to have on hand, before deciding on warehousing needs.

Furthermore, traditional offices may be less essential. Weigh the pros and cons of cutting your office space to determine what physical presence is truly necessary. If cuts are required, it may be worth considering what is likely to take your business further: an intact workforce or a physical office.

The same question can be asked of equipment. Servicing and maintaining a fleet of heavy machinery may be more costly than it's worth if certain types of projects are slowing down. It's particularly important to carefully assess equipment needs in a high-interest rate environment when equipment costs typically rise by around 7% to 10%.

4. Optimize Your Tax Position

Turning back to contracts, far too many construction businesses are under-equipped to get the full value of their contracts. That's because relatively few are aware of the options available when it comes time to pay and file their taxes. The nature of your work, and the fine print within your contracts, offer a number of options during tax season. Taken together, a certified public accountant (CPA) can review your entire portfolio of work to elect certain methods that may result in a more favorable tax bill compared to a similar business that files and pays taxes without detailed knowledge of the opportunities available.

Moreover, the tax code that applies to construction businesses is so detailed and intricate that only specialized industry accountants can be expected to stay current on all the accounting methods available for certain construction jobs and the impact those methods have on your tax position. Maximizing the value of your contracts can do wonders for cash flow, so if you're thinking of tax consulting as an added expense, you may not realize just how effective method changes can be when it comes to keeping cash on-hand and available.

In any market environment, businesses control several factors affecting cash flow. Contracts (both their terms and accounting methods implications), credit management and expense elimination are all powerful levers that virtually any business can use to optimize cash flow.

Marty McCarthy, CPA, CCIFP, is a partner in Marcum LLP's Tax & Business Services division and serves as the firm's mid-Atlantic construction leader. With more than three decades of experience working with construction companies, his collaborative and solution-focused approach, technical proficiency and deep industry knowledge have made him a trusted advisor to contractors looking to operate more efficiently and optimize growth. Visit marcumllp.com.

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