

Best Practices For Bad Times

Clifton Gunderson Stresses Fundamentals

Some construction industry analysts see the American Recovery and Reinvestment Act of 2009, and subsequent extensions of some of its provisions, as a mixed blessing.

On the one hand, the massive economic stimulus package is pumping billions of dollars into the economy, with a large percentage going to infrastructure and public works improvements. On the other hand, there are construction companies out there that, after several years of living hand to mouth, are still desperate for work. Competition for stimulus-funded projects is fierce, and margins are often slim, putting some on shaky financial ground.

While contractors in virtually every state are bidding on roads, bridges, new government buildings, schools and other large projects, experts caution bidders to be aware of the pitfalls that go along with the opportunities.

“It’s rarely a good practice to take on work with little or no margin just to keep employees busy and prevent layoffs,” says Jeff Tyner, leader for Clifton Gunderson’s local construction practice. “Unprofitable work only compounds cash flow problems. If something goes wrong on the project it could sink a company that is already on shaky ground.”

He says some contractors are consciously not bidding on ARRA-funded projects due to the level of competition and slim margins.

Tyner also cautions against stretching normal geographic boundaries and specializations in an attempt to build up a backlog. Instead, he urges construction companies to remain financially strong by avoiding common financial mistakes. Accurate budgeting and estimating, cost controls, tax optimization and strategic growth planning are good business practices in any economy. He says contractors seem to get into the most trouble when they do not proactively manage and plan in two significant areas: overhead costs and cash flow.

CONTROLLING OVERHEAD COSTS

Construction companies have a tendency to overlook overhead costs when setting rates and preparing project bids. As a result, a job that appears marginally profitable may actually lose money when overhead costs are factored in.

Contractors often fail to consider indirect costs like insurance, equipment and support staff (supervisors, clerical workers, etc.). It is critical to recognize these costs when calculating rates and margins, while also working to manage and control them on every job.

MAXIMIZE CASH FLOW

Contractors of all sizes suffer the consequences of poor cash flow management. When business is good, a company can bleed cash knowing that there will always be another job and a fresh infusion of working capital. It’s the multi-year projects, unanticipated cost fluctuations and periods of hit-and-miss work that quickly drain cash reserves and drag a company down.

Financial institutions will come to the rescue with short-term working capital only so many times before demanding more effective financial management. Under the current conditions, banks are being much more cautious with the cash needed for working capital. Some banks are even finding ways to pull credit arrangements based on covenant violations.

SOME ADDITIONAL ADVICE

- Negotiate increases in your line of credit threshold before you need it, to assure adequate cash flows when you do.
- Maintain and strengthen relationships with clients, prospects, bonding companies and financial institutions before your survival depends on those relationships.
- Review equipment needs and dispose of idle equipment. The sale may

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bring in some much-needed cash and eliminate ownership costs like insurance.

- Protect your interests with construction or mechanic’s liens. When filed correctly and in a timely manner, a construction lien can help recover payment when a project comes to a halt or payment is late.
- Work with legal counsel to assure that your standard contracts address key issues that may arise and that the company is adequately protected.

OPTIMIZE YOUR EFFECTIVE TAX RATE

Optimizing your effective tax rate can also enhance cash flow. Every dollar not spent on taxes can be put to more profitable use.

An example is the HIRE Act (Hiring Incentives to Restore Employment), the recently passed federal jobs bill that offers tax incentives for hiring and retaining new workers. HIRE also extends Section 179 expensing for another year. These incentives encourage businesses to hire workers and make capital expenditures, which is good for the economy, while reducing tax liability, which is good for cash flow.

Even if you’re not ready to start hiring, higher expensing deductions are worth discussing with your financial officer and your tax advisor. Ask about other unutilized or underutilized tax benefits, like deductions for energy efficient construction and renovations, which can be especially beneficial to contractors building or upgrading government buildings.

“Fortunately, construction is a cyclical business that almost invariably returns with the same or greater strength,” Tyner concludes. “Contractors who manage cash flow and overhead costs will remain strong and are more likely to survive until things improve.”