Managing Cash Flow in Construction

> “*We were always focused on our profit and loss statement. But cash flow was not a regularly discussed topic. It was as if we were driving along, watching only the speedometer, when in fact we were running out of gas*.” – Michael Dell, Founder & CEO of Dell Technologies

It takes a broad skill-set to run a successful construction business and navigate the significant risks inherent in the industry. Not only do you need to know the ins and outs of construction, you must also be skilled at business management and finance. From executing contracts to understanding the bid process to managing resources, not the least of which is cash. The quote above from Michael Dell about cash flow is very timely and applicable for contractors. A large surety company recently listed its “Top 10 Reasons Contractors are at Risk of Failing,” with Insufficient Cash Flow as #4 on the list. Cash flow issues have historically been at the top of similar lists of construction industry risks. The ability to quickly access cash is the universal resource to fix just about any issue that arises.

Managing cash flow is like managing a race – knowing where the checkered flag is, who is on your pit crew, when to make the pit stops and having the fuel available when you pull into pit row are all critical elements that must fall into place in order to win the race. When looking at your cash flow, you need to know when it’s coming in and from where so you can optimize its output and maximize your company’s performance. Using cash flow projections, you can tell when you need to fuel up (start building cash balances or borrow), and when to push the figurative pedal to the metal. In terms of car racing, good drivers pay attention to these items and do well over time, winning several races a year. Great drivers look closer and fine tune the engine to get the best possible performance so they can win the Cup Series. For a construction company, the engine is the contracts they execute and, specifically, the clauses they include or strike from the contract. **By tweaking contract terms and having the discipline to not agree to adverse conditions, contractors can access the cash needed to be successful.**

Reviewing construction contracts over the last thirty-five years has helped me identify some of the more problematic clauses that may crop up in a contract for prime- or sub-contractors.   Here is a cash flow checklist for contractors that I ran across early in my career that, with a little tweaking, still holds true today and points out critical contract details that will affect cash flow.

It is important it is to review contracts in their entirety – the plans and specs, as well as the general and special or supplemental conditions. While it’s crucial to focus on what’s being built – confirming that there are complete plans or contingencies for unclear design are key to a profitable project. However, the general/special/supplemental conditions contain contract terms that control the cash flow on the project: when are invoices due, when they’ll be paid, how much retainage will be held, etc. While review of the contract conditions seems obvious, I’ve seen retainage clauses with 55% retainage that no one noted until late in the bid process. It ended up being a typing error corrected through an RFI.

Something that is often overlooked but could be critical, are flow-down provisions. Flow-down provisions bring terms and conditions in upstream contracts into your contract by reference. While most often seen in subcontracts, they are sometimes seen in owner-prime contracts – particularly on P3 or build/lease projects. These provisions can be subtle and are easy to miss. Part of the problem is that there isn’t standard language or location for these clauses. Flow-down provisions can be in the contract preamble, included in the scope of work or buried in the definitions section of a contract. Wherever they are located, they may contain terms that can significantly impact the risk and cash flow of a contract. Unfortunately, damages are frequently one of the key provisions that flow down. Finding an uncapped, $50,000 per day LD clause after you've signed a $250,000 contract is a real problem.

Sometimes, although a flow-down provision is included in the contract, the upstream contract isn't provided or is heavily redacted. **Be sure to condition your bid or proposal on full access to the upstream contract (and any subsequent change order or addendum) and/or limit the liability to those provisions to an acceptable amount. Remember that a contractor's best contract maybe the one it walks away from.**

Construction is an intrinsically tough business – the contractor is working with dozens of sub-contractors, sub-sub-contractors, suppliers, laborers and code enforcement inspectors to build a project based on an architect or engineer's interpretation of what an owner wants and to deliver it when they want it. **In construction, it's not a matter of *if* something will go wrong, but rather a matter of when.** When you do hit that bump in the road, be sure you have plenty of gas (cash flow) to power through it.

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