

MANAGING DURING Uncertain Economic Times

BY ROBERT PAZ

Upon looking back, early 2007 probably will mark the beginning of the end of an unprecedented period of prosperity for the construction industry. In the preceding few years, work was plentiful and profit margins were high. The residential construction market was at its peak. Material prices had stabilized, and cheap credit funded growth.

Then in 2007, the U.S. housing bubble burst. The credit markets started to tighten as the sub-prime mess surfaced. The rising price of oil disrupted an already shaky U.S. economy. Many states and municipalities reported significant budget deficits that would minimize investment in new public works projects.

Now, near the end of 2008, the residential construction market has crashed in most regions and it's only a matter of time before the rest of the construction industry feels the pain. As contractors enter these uncertain economic times, some companies will fare better than others. Now is the time to implement sound financial management practices and plan for the rough road ahead.

STEP ONE: CASH MANAGEMENT

Cash is the lifeblood of a business. As revenue begins to decline and the credit crunch worsens, a company must build and manage cash reserves to survive.



How much cash is on hand and how is the company holding these funds? With so many banks under stress from the credit



crisis, it's important to understand a bank's financial condition. Now is not the time to take for granted the FDIC's coverage on account balances of up to \$100,000. Contractors carrying balances over the FDIC limit should not necessarily move their money to numerous accounts to stay under the limit. Bankers and financial advisors can reveal the best ways to hold and invest excess funds.

Next, develop tools to manage and project future cash flow. What is the status of accounts receivable? How much will the company collect in the next three months? Of the rest, how much can the company realistically expect to collect in the future and how much is a lost cause? On the liability side of the ledger, how much does the company owe to vendors and what does it owe under term debt and revolving lines of credit?

This rolling cash flow projection forecasts two to three months ahead so a company



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Next, evaluate the reduced overhead relative to the current backlog of work. Project the amount of work to be completed each month during the next year. Add in any new work to start during this projection period. Subtract all associated direct costs (i.e., materials, labor, subcontractors and equipment). The amount left over is available for overhead absorption and debt service. If the company is in the red or showing a razor thin margin, go back and cut more overhead.

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can better manage cash reserves and predict potential problems.



STEP TWO: EMPLOYEE MANAGEMENT

When revenue begins to dip, contractors may fall into the trap of accepting work only to keep their employees busy. This leads to unprofitable work and ties up limited cash reserves, which weakens the company and could put it out of business. Focus on the best people and manage projects to completion with the least amount of manhours. For example, eliminate overtime, cut crew sizes, and consider shortened workweeks, rolling layoffs and extended vacations.

STEP THREE: EQUIPMENT MANAGEMENT

Owned equipment, even if idle, must be stored, insured and maintained, which ties up



precious cash and capital. Own only what the company needs, and do not take on work simply to keep equipment busy. Also, do not purchase new equipment simply to take advantage of the government's incentive of 50 percent bonus depreciation and the \$250,000 Section 179 deduction.

STEP FOUR: OVERHEAD MANAGEMENT

In good times, overhead swells and companies get "fat." Consider ways to trim every overhead item without compromising project management. Detail the company's current fixed monthly overhead by breaking it down into categories such as project management, estimating, marketing and business development, building and occupancy costs, accounting and office administration, and owner's salary. Shut down extra phones and scale back unnecessary expenses.



STEP FIVE: BANKING AND SURETY RELATIONS

A company's banker and surety must be allies in good times and bad. Keep these organizations informed of the bad news as well as the good. Communicate the steps the company is taking to weather tough economic times.

With every economic downturn, there is a silver lining. Downturns in the construction economy are a weeding out process in which many poorly managed or weak competitors disappear. The tight labor market also loosens, resulting in opportunities to hire quality employees and closely examine business operations.

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