CONSTRUCTION EXECUTIVE

Cash Flow Considerations in the Bidding Process

By Richard P. Higgins | Wednesday, January 20, 2021

It is important for a contractor to have a positive cash flow. It can make the difference between having a sustainable company or not, especially considering the COVID-19 pandemic. Contractors with a positive cash flow are more likely to survive a business interruption, shutdown or any of the challenges faced due to the coronavirus.

Cash flow is defined as the movement of cash into (income) or out of (expenditure) a company. Cash inflow comes from the sale of goods and services, the sale of assets or money obtained from financing. Cash outflow occurs when a contractor purchases materials and equipment; meets payroll; pays rent, insurance, and other business expenses; and makes loan payments.

Positive cash flow occurs when a contractor is bringing in more money than they are spending during a specific period or over time. Negative cash flow is the opposite. There is not enough cash to cover expenses. Being in a positive cash flow position is necessary to have a solvent business.

Profitable companies can become insolvent because of uneven cashflow. This could force a contractor to tap into a line of credit or take out a loan to continue operating and meet expenses.

CASH FLOW MANAGEMENT

Cash flow management is the process of balancing the inflow and outflow of cash. In construction, cash inflow occurs as incremental payments are made by the owner over the course of the job. Cash outflows are made as the contractor buys materials and supplies, pays subcontractors and employees, or pays overhead and equipment costs. It is important that the contractor considers cash flow over the life of a project and during each phase of construction to ensure the money is available to cover the necessary expenses.

It is also essential that the contractor considers cash flow in the bidding process, which can be difficult. A contractor can lose money on the job if the bid is too low or have the bid rejected if it is too high. Accurate estimates are key to managing cash flow.

PAYMENT SCHEDULES

Invoices are typically sent out according to the payment schedule outlined in the contract. Payment schedules are determined by either a percentage of completion or meeting specific milestones. The contractor and the owner must agree on the terms of the payment schedule and how disputes will be resolved. A disruption could cause a payment delay which would interrupt cash flow and possibly the contractor's ability to complete the job.

MANAGING COSTS AND SUPPLIES

Increasing labor and material costs are making margins tighter than ever before. Higher than expected costs could put a contractor into a negative cash position. Tariffs, trade wars, and demand for certain materials are adding to escalating prices, as well as the need to meet the guidance from the Centers for Disease Control and Prevention on protecting workers on the job. Contractors need to consider inflation while preparing a bid, as well as their profit margin to mark up the estimated costs accordingly.

As the pandemic continues, it might not be possible to get certain materials. Suppliers will be more likely to deliver materials to contractors that are in the position to pay for them. Contractors will need to estimate how much material they will need and include the cost in the contract to ensure that the money is available when needed.

A contractor should account for changes in the costs of materials and labor, as well as the build schedule, to avoid cost overruns. This will help to ensure there is adequate cash flow to complete the job and make a profit. Major changes to the scope of the project or timeline will need to be addressed. If necessary, the payment schedule will need to be updated.

CASH FLOW CYCLE

Comparisons should be made to prior periods and similar jobs to determine the company's cash flow cycle. Having current and historical information on cash flow will help a contractor to:

- understand the company's cash position;

- prepare for changes in the company's cash position;
- control accounts receivables;
- manage cash expenditures; and
- make decisions based on what the business can afford.

Managing cash flow allows a contractor to identify issues and take corrective action before there is a serious problem. By considering cash flow in the bidding process, a contractor should be better prepared to complete each phase of construction based on the inflow and outflow of cash.

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