



Eight Cash Flow Tips for Your Construction or Real Estate Development Firm



Eight Cash Flow Tips for Your Construction or Real Estate Development Firm

By: Craig Mann

Contents

Eight tips to Improve your cash flow.....	2
One - Regularly Monitor Your Budget.....	2
Two - Always Forecast Your Cash Flow.....	3
Three - Maintain a Profit-First Mindset and Culture.....	3
Four - Implement Clear Payment Schedules for Owners and Subcontractors	4
Five - Allow Customers Multiple Ways to Pay	5
Six - Effectively Manage Accounts Receivable Collection Process and Payment Incentives	5
Seven - Leverage Technology to Automate Processes	6
Eight - Manage Vendor Invoice Payment Terms and Timing of Payments	7
Conclusion	8
Appendix for Formulas Samples:.....	10



Eight tips to Improve your cash flow.

Effective cash flow management is the lifeblood of any construction firm. Here are eight advanced strategies to enhance your cash flow, ensuring your business remains financially robust and capable of handling new projects.

One - Regularly Monitor Your Budget

Consistent budget monitoring is paramount for identifying variances and making timely adjustments. Utilize advanced budgeting software to track expenses in real-time, compare actual costs against estimates, and generate detailed financial reports. This initiative-taking approach helps in maintaining financial discipline and avoiding unexpected cash flow disruptions. Regularly review your budget against the project milestones to ensure alignment and make necessary adjustments promptly. Implement variance analysis to understand the causes of the budget deviations and take immediate corrective actions.

Examples:

- Use industry specific software to track project expenses in real-time. Set up alerts for when costs exceed budgeted amounts, allowing for immediate corrective action.
- Conduct monthly budget reviews with project managers to compare actual costs against estimates and discuss any variances.
- Implement a rolling budget system that updates monthly to reflect changes in project scope and costs, ensuring continuous alignment with financial goals.
- The SPI and CPI are a couple of key indices you may consider utilizing to identify variances in the construction schedule and costs associated with the project budget which can affect your cash management.
 - Schedule Performance Index (SPI) - The (SPI) is a measure of schedule efficiency on a project. It indicates how efficiently the project team is using time compared to the planned schedule. If a project is behind schedule, there is a risk of cash and profit erosion. $SPI = EV/PV^1$

¹ **EV** = (Earned Value): The value of work performed up to a specific point in time. **PV** = (Planned Value): The value of work that was planned to be performed up to that same point in time. **SPI > 1**: The project is ahead of schedule. **SPI = 1**: The project is on schedule. **SPI < 1**: The project is behind schedule.



- Cost Performance Index (CPI) - The (CPI) is a measure of cost efficiency on a project. It indicates how efficiently the project team is using the budget and is beneficial to cash management. $CPI = EV/AC^2$

Two - Always Forecast Your Cash Flow

- Implement sophisticated cash flow forecasting models that incorporate historical data, project timelines, and market trends. Use predictive analytics to anticipate future cash needs and potential shortfalls. Regularly update your forecasts to reflect changes in project scope, payment schedules, and economic conditions, ensuring you have a clear financial roadmap. Incorporate scenario planning to prepare for various financial outcomes and develop contingency plans. Utilize software tools that integrate with your accounting system to provide real-time updates and accurate forecasts.

Examples:

- Tools like Sage, Viewpoint, and CMIC are available in the marketplace, which can create detailed cash flow forecasts. They also can incorporate data from past projects to predict future cash flow needs and adjust for seasonal variations in construction activity.
- Develop multiple cash flow scenarios (best case, worst case, to prepare for different financial outcomes and create contingency plans accordingly.
- Integrate your cash flow forecasting tool with your project management software to automatically update forecasts based on project progress and changes.

Three - Maintain a Profit-First Mindset and Culture

- Embed a profit-first philosophy across your organization by setting clear financial goals and performance metrics. Train your team in cost management techniques and incentivize them to identify and implement cost-saving measures. Regularly review

² **AC** = (Actual Cost): The actual cost incurred for the work performed up to that same point in time.

EV (Earned Value): This represents the budgeted amount for the work completed by a certain date. It is calculated by multiplying the percentage of work completed by the total project budget (Budget at Completion, BAC). **AC (Actual Cost)**: The actual cost incurred for the work performed up to the same point in time. **CPI > 1**: The project is under budget. **CPI = 1**: The project is on budget. **CPI < 1**: The project is over budget.



project profitability and adjust strategies to maximize margins without compromising quality. Encourage a culture of financial accountability where every team member understands the impact of their actions on the firm's profitability. Conduct regular financial training sessions to keep your team informed about best practices and industry standards.

Examples:

- Implement a profit-sharing program where employees receive bonuses based on the profitability of projects. Use KPIs³ such as gross profit margin (GPM)⁴ and net profit margin (NPM)⁵ to measure performance and make informed decisions.
- Conduct quarterly financial training sessions for project managers and key staff to educate them on cost management techniques and the importance of maintaining profitability.
- Establish a cost-saving task force to identify and implement efficiency improvements across the organization, such as reducing waste or negotiating better rates with suppliers.

Four - Implement Clear Payment Schedules for Owners and Subcontractors

- Develop and enforce detailed payment schedules that outline milestones, deliverables, and payment terms. Use contract management software to automate invoicing and payment reminders, reducing administrative overhead and ensuring timely payments. Clear communication and documentation help prevent disputes while maintaining a steady cash flow. Ensure that all parties are aware of the payment terms and enforce them strictly to avoid delays. Establish a system for tracking payment progress and addressing any issues promptly.

³ **KPI** = Key Performance Indicators

⁴ **GPM** = $\text{Revenue} - \text{COGS} / \text{Revenue} * 100$. Gross Profit Margin is a financial metric that shows the percentage of revenue that exceeds the cost of goods sold (COGS). It measures how efficiently a company is producing and selling its products or services.

⁵ **NPM** = $\text{Net Profit} / \text{Revenue} * 100$. Net Profit is the total profit after all expenses, including operating expenses, interest, taxes, and any other costs, have been subtracted from total revenue.



Examples:

- Use software like GCPay or Textura to manage payment applications and ensure that all parties adhere to agreed-upon payment schedules. Automate reminders for upcoming payments to avoid delays.
- Create detailed payment schedules within your contracts that specify payment milestones tied to project deliverables, ensuring clarity, and reducing the risk of disputes.
- Hold regular meetings with subcontractors to review payment schedules, address any concerns, and ensure alignment on payment expectations.

Five - Allow Customers Multiple Ways to Pay

- Enhance payment flexibility by integrating multiple payment gateways into your billing system. Accept credit cards, ACH transfers, and digital wallets to accommodate client preferences. Implement secure online payment portals that streamline the payment process and reduce delays, improving cash flow efficiency. Offering various payment options can also improve customer satisfaction and reduce the likelihood of payment disputes. Ensure that your payment systems are secure and compliant with industry standards to protect sensitive financial information.

Examples:

- Integrate payment solutions like Stripe or PayPal into your invoicing system to offer clients multiple payment options. Ensure that your payment portal is mobile-friendly to facilitate on-the-go payments.
- Implement an online payment portal that allows clients to view invoices, make payments, and track payment history, improving transparency and convenience.
- Offer ACH payment options for larger transactions to reduce processing fees and ensure faster fund transfers.

Six - Effectively Manage Accounts Receivable Collection Process and Payment Incentives

- Optimize your accounts receivable process by implementing automated invoicing and follow-up systems. Use customer relationship management (CRM) tools to track



payment histories and send timely reminders. Offer prompt payment discounts or other incentives to encourage prompt payments and establish clear policies for handling overdue accounts. Regularly review your accounts receivable aging reports to identify and address any potential issues early. Implement a robust credit management system to assess the creditworthiness of new clients and mitigate the risk of non-payment. Keep in mind, if you offer discounts, what are the benefits and costs of those discounts? A 2% (2-10 Net 30) discount could have an annualized cost of 37%⁶

Examples:

- Use CRM tools like Salesforce or HubSpot to manage client interactions and track payment histories. Implement a prompt payment discount program, offering a 2% discount for payments made within 10 days as necessary and beneficial to the firm and subject to current market rate cost of capital.
- Automated invoicing and follow-up reminders using software to ensure timely billing and reduce the risk of overdue payments.
- Conduct regular reviews of your accounts receivable ageing reports to identify overdue accounts and consider initiative-taking steps to collect outstanding payments.

Seven - Leverage Technology to Automate Processes

- Invest in construction-specific financial management software that integrates with your project management tools. Automate tasks such as invoicing, expense tracking, and financial reporting to reduce manual errors and save time. Utilize data analytics to gain insights into cash flow patterns and identify areas for improvement. Automation can also help in reducing administrative costs and improving overall efficiency. Explore the use of artificial intelligence and machine learning to enhance your financial forecasting and decision-making processes.

⁶ Cost of Discount = (Discount percentage/100-Discount Percentage) * (365/Payment Period-Discount Period).

Sample: 2% 10 Net 30

Cost of Discount = $(2/100-2) * (365/30-10)$.

Cost of Discount = $(2/98) * (365/20)$

Cost of Discount = $.0204 * 18.25$

Cost of Discount = 0.372 or 37%



Examples:

- Use software like Viewpoint or CMiC to automate financial processes and integrate them with your project management systems. Employ AI-driven analytics to predict cash flow trends and identify potential issues before they arise.
- Implement Robotic Process Automation (RPA) to handle repetitive tasks such as data entry and invoice processing, freeing up staff to focus on higher-value activities.
- Use machine learning algorithms to analyze historical financial data and improve the accuracy of your cash flow forecasts.

Eight - Manage Vendor Invoice Payment Terms and Timing of Payments

- Negotiate favorable payment terms with your vendors to align with your cash flow cycles. Aim for extended payment terms that provide flexibility without straining vendor relationships. Strategically schedule payments to optimize cash flow, taking advantage of any available discounts for early payments while maintaining sufficient liquidity. Regularly review your vendor agreements to ensure they continue to meet your financial needs and renegotiate terms, as necessary. Establish strong relationships with key suppliers to secure better terms and ensure timely delivery of materials.



Examples:

- Negotiate 60-day payment terms with your suppliers to align with your cash inflows. Use accounts payable automation tools like Bill.com to schedule payments strategically and take advantage of prompt payment discounts when beneficial.
 - Implement a vendor management system to track payment terms, monitor supplier performance, and ensure timely payments.
 - Develop a strategic sourcing plan to identify and partner with key suppliers who can offer favorable payment terms and reliable delivery schedules.
 - A 2% (2-10 Net 30) can save 37%⁷ annualized dollars if your cash flow is strong enough to take advantage of discount terms. Alternatively, a 2% 15 Net 60 would produce a 16% savings with the same annualized calculation.

Conclusion

- By implementing these expert strategies, your construction firm can achieve superior cash flow management, ensuring financial stability and the capacity to take on new projects with confidence.

⁷ Cost of Discount = (Discount percentage/100-Discount Percentage) * (365/Payment Period-Discount Period).

Sample: 2% 10 Net 30

Cost of Discount = $(2/100-2) * (365/30-10)$.

Cost of Discount = $(2/98) * (365/20)$

Cost of Discount = $.0204 * 18.25$

Cost of Discount = 0.372 or 37%



Appendix for Formulas Samples:

$$\text{Cost Performance Index} = \frac{\text{Earned Value}}{\text{Actual Cost}}$$

$$\text{Cost Performance Index} = \frac{\text{Earned Value}}{\text{Actual Cost}}$$

$$\text{Net Profit Margin} = \left(\frac{\text{Net Profit}}{\text{Revenue}} \right) \times 100$$

$$\text{Gross Profit Margin} = \left(\frac{\text{Revenue} - \text{COGS}}{\text{Revenue}} \right) \times 100$$

$$\text{Cost of Discount} = \left(\frac{\text{Discount Percentage}}{100 - \text{Discount Percentage}} \right) \times \left(\frac{365}{\text{Payment Period} - \text{Discount Period}} \right)$$