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The Confidential Guide to Protecting Cash Flow in Difficult Times

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What Mama didn't tell you about cash flow management for contractors, sub-contractors, suppliers, engineering firms, home-builders, developers, architects, retailers and other business owner's in cyclical businesses.

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Difficult times call for difficult measures. This guide was written to help you understand how you can maintain cash flow during times of extreme revenue reductions which sometimes occur in cyclical businesses. The techniques begin with the usual cash management suggestions and become progressively extreme. The extreme measures do not ensure success and are to be used as last ditch efforts to salvage your company prior to bankruptcy. In past recessions I have seen or used each of these techniques. As unpleasant as it may seem almost all vendors and all employees returned when work returned. Life in the jungle can be severe and your first duty is to survive.

The key is to protect your business by carefully hoarding your cash.

Cash flow is the equivalent of blood in your body. An otherwise healthy person can bleed to death. An otherwise healthy business can run out of cash in difficult times.

The best defense to either bleeding to death or running out of cash is to avoid the accident. This takes foresight and planning. It mainly involves taking action early while you still have options. If you wait too late to start your options will be seriously limited and the likelihood of business survival is reduced. If you have cash you can negotiate and try to make deals. Once all your cash is gone you can start trying to renegotiate or obtain concessions but you will find you “have no powder in your gun” and will not get far. **Analyze, Plan, and take Action early. Always conserve cash.**

Taking action means constant communication. Unpleasant news sincerely given is much better than no news. Return calls from creditors and bankers and remain empathetic and optimistic.

Recognize that during times of difficulty many of these techniques may be applied to you. This greatly increases business risk as non-payment becomes a real possibility. Carefully assess who you are working for and their ability to pay. Recognize that many good people may be put in impossible situations where they can not pay you.

Something that must be stressed is that you must maintain your desire to see your way through the difficulties and keep attacking. **Your positive attitude and persistence in the face of adversity is essential.** Keep your balance and your eye on the goal of getting through the difficult times.

The Confidential Guide to Protecting Cash Flow in Difficult Times

Suggested Measures:

Strategy and Planning

1. Prepare three versions of your financial cash flow – the first is your goal, the second is your likely and the third is your worst case. In many construction related industries worst case may be a 50% reduction in revenue or more. Do this now, today.
2. Important indicators that show continued productivity are revenues per employee or hours worked per dollars collected, gross margin, and total overhead load as a percentage of total revenues. These show if productivity is climbing or falling. Track them and other essential numbers. Monitor these regularly.
3. Map out key milestones such as delays in job starts, revenues falling to specific points, or crew down time, to help you determine when you must begin to implement the steps necessary to maintain cash flow due to falling revenues. In almost all cases owners tell me they started implementing cost saving measures too late. No matter how disheartening it is in the short run you must take decisive action as early as possible. Sometimes the leg must be amputated to save the patient.
4. Examine every overhead line item. You can live with a whole lot less. Start now.
5. Develop a plan to keep your service level high and your production on schedule at all levels of revenues. At the lowest level you may need to renegotiate leases, pay off credit lines, cut staff, and more. Map it out.
6. Get your cash flow at each revenue level to break-even or better.
7. Be wary of fooling yourself that cash flow will continue. Everyone has a full backlog of jobs that just don't start. Go through your backlog with an impartial outsider. This makes it harder to see what you want vs. what is really happening. Aggressively court real work that is likely to start. Do your best to keep a profit margin in this work if possible.
8. Look for new revenue sources and market aggressively into them. Service work and some niche markets always stay strong.

The Confidential Guide to Protecting Cash Flow in Difficult Times

9. Carefully assess if you will get paid for your work. This sounds basic but a few substantial non-payments can take a good company out. Avoid having more than 10 or 15% of your work from one customer to reduce nonpayment risk. If you can, understand who else your clients are working for – will they get paid on those jobs and yours? Manage the amount of credit you extend to slow payers. At some point the risk of nonpayment of huge receivables can become too large to take.
10. Organize your payment priorities. In general you must pay banks, utilities, landlords, suppliers you need soon. Bonded jobs have much more risk for you and should have a priority over unbonded work. Look at who you have given personal guarantees to and to who you have not. Recognize that if your spouse signed the personal guarantees with you or if you have collateralized your obligations that these tend to be highly collectable. The less you need someone, or the less leverage they have over you the slower you can pay them.
11. If your wife or husband is not on personal guarantees make sure your assets are owned as tenants by the entirety (at least in Maryland.) (Make sure you get along with your spouse or think hard about this). Beware that banks may require your spouse to join your guarantees in the future. This is fairly customary when the economy gets difficult and it is a true Hobson's Choice. I.E. You are likely to lose either way and need to carefully assess the value of the protected assets vs. the likelihood of success or failure of the business under the circumstances. Sometimes it is better to walk away while you can.
12. Pay payroll taxes. These are not dischargeable in bankruptcy and become a personal liability of the owner and who-ever does payroll and signs the checks. While this is the easiest payment to skip it can be devastating downstream when you try to expand again or start back up.
13. As an aside an effective way to handle personal guarantees from suppliers is to change the credit application or guarantee form so that the guarantee expires after two years unless the supplier obtains a new one. This often will be accepted by the supplier, rarely remembered and renewed, and will put you in a much stronger position next time things get difficult.
14. Review your strategies and plans with an attorney and other advisors prior to implementation. The attorney can help you understand the legal ramifications of what you are doing in your jurisdiction. Lien laws and contract laws vary in different jurisdictions and that may affect your strategy. This article is a guide to

The Confidential Guide to Protecting Cash Flow in Difficult Times

developing a plan for survival and not legal, accounting, or tax advice as each situation is different.

15. If circumstances are dire consider bankruptcy. At some point it is better to throw in the towel and start again when the market returns. We have seen many people restart fairly quickly in partnerships with children, key employees, or financial backers.

Staff

1. Evaluate each person on your staff. Compare costs vs. outsourcing. Many positions can be outsourced with the internet. Realistically assess needs during slow periods. For instance estimating probably will be much slower during a severe downturn than during busy periods. Can an assistant take over the role during slow periods? Much more money can be saved letting high dollar people go instead of low dollar. Unfortunately for many businesses payroll is one of the largest cost centers and must be curtailed.
2. Consider asking your staff to take salary reductions, work part time, piece work, reduce benefits, etc. They may be more flexible than you think. Something is often better than nothing.
3. Try to lay everyone off at once if possible. Crews may be reduced as work is completed but at least the office and administrative jobs can be reduced at the same time. A big reduction with the explanation that you had to get down to fighting size is easier for the survivors to take than a slow painful trickle of people leaving. Do everything possible to keep morale up.
4. Make it clear that this is a reduction forced by the economy and not a reflection of the discharged employee. If they leave on good terms you can re-hire them when the economy improves.
5. If possible place people into new jobs. We know of one contractor that placed several people with maintenance organizations in several downturns and hired them back when work picked back up.

The Confidential Guide to Protecting Cash Flow in Difficult Times

Cash Management

1. Send out bills and invoices promptly. I have seen them sent out before the work was done. Certainly send them out as soon as the work is done. If billing off an AIA type schedule bill through at least the inspection date. If you bill ahead of your work or if your payment schedule has some front-end load remember that the shortfall in the back will come and plan for it. In slow times completing the work when the back-end is under funded can be very challenging.
2. Negotiate payment for materials stored in your shop or yard. Collect deposits whenever possible. If you are a low cost provider you may be able to get special payment terms such as weekly or bi-weekly payment.
3. Institute polite but firm collection procedures. Within reason the squeaky wheel gets the grease.
4. Defer making payments as long as possible without getting cut off by your vendors. Negotiate extended payment terms when possible. If you absolutely cannot make your payment terms talk to creditors and let them know what is going on and that you are continuing to pay as part of an orderly process. You may be able to negotiate additional needed deliveries if you can explain when you can make some payment. The future payment must come through on that date or all credibility will be lost. Communications and patience is essential. Working with vendors on payments and deliveries may become a big part of someone's job description.
5. Look to refinance or renegotiate loans to get extended payment terms. In general this can be very difficult to do with banks. Banks tend to have meaningful personal guarantees and often have collateralized other assets like your home or vacation property. Usually better terms in bank loans means changing banks. When looking at banks try to assess how they have historically addressed clients with difficulties. Smaller lenders often are more flexible than larger lenders but often cost a little more. If changing lenders is a viable alternative prepare a professional bank package and shop it around. In all cases keep on good terms with your banker and communicate, communicate, and communicate.
6. Track your cash, receivables, and payables daily. Have a 30 day projection that you update regularly. In critical times cash flow is like a chess game where you must plan for the next move and your 10th move from now.

The Confidential Guide to Protecting Cash Flow in Difficult Times

Purchasing and Subcontracting

1. Recognize that just as your costs are coming down many of your subcontractor and supplier's costs are also being reduced. Make your final purchase close to the time the work is actually ready to start. Often you will find someone that wants to keep a crew busy, has the material in stock and wants to turn it, or even just get another shipment in this month's numbers. These types of motivations often help vendors really sharpen the pencil.

Inventory

1. **Protect Your Inventory from Theft:** Employee pilfering is expensive. Put office supplies in locked or watched closets. For warehouses and worksites more extensive systems may be needed to reduce theft. A security contractor we talked to said camera systems have become inexpensive and are being installed in many plants and warehouses to protect against employee theft. Keep your inventory from walking off.
2. **Manage Ordering and Reduce Inventory:** In slower times cut down on the inventory you carry. For many businesses the advent of air freight and direct shipping has reduced the need to have endless inventory in stock. Factoring in the cost of money, shipping, storage, handling, and tracking costs many inventory items that sell slowly do not make a real contribution to your bottom line. As you sell off your slow sellers, do not replace them. I am always being told by suppliers that they need to have everything in stock. This is not always true in slow times. Remember your suppliers are likely to ship faster and stand on their heads to help you make fill a large or unusual order in a slow environment.
3. **Increase Inventory Turn:** Inventory turn is the number of times you sell your complete inventory in a year. Work to increase your inventory turn. The more you turn inventory the more efficient your inventory investment. Again look at stocking samples and direct shipping. If you are a contractor or manufacturer focus even more on just-in-time delivery of components. Increase inventory turn.
4. **Install Inventory Tracking Systems:** If inventory is a large part of your business modern tracking software and systems are a must. This can be a large up

The Confidential Guide to Protecting Cash Flow in Difficult Times

front cost and a major change in how the people in your firm operate but cost savings and profit increases from really knowing what is going on with your inventory can be spectacular. Additionally, if you decide to sell the business your buyers will be able to understand what is going on with your inventory.

5. **Take Inventory:** A periodic physical inventory is important in order to really know what you do and don't own. Without a periodic inventory it is impossible to assess if your cost of goods sold and your profit or loss is correct. Do not skip taking inventory. In difficult times it is more important than ever to really know what is going on.

Now is the time to reduce all costs including those associated with excess inventory. Carefully manage your physical inventory and don't be afraid to pick up the phone and negotiate on future shipments.

Distress Cash Management Procedures

There is a fine line when to implement these procedures. It will vary on your trade, how leveraged or how much overhead you must support, and how far you expect revenues to fall. **These measures can cause additional problems including the loss of credit and credit ratings but at some point may be the only avenue to survival.** Again, there is a fine line between waiting too long to start and starting too early.

1. Determine which vendors you no longer need and stop paying them. Negotiate a discounted payment on any amount due to them. Expect these negotiations to take three to six months. They may file a lawsuit to collect. Take time to explain your situation to them and explain that something is better than nothing. Make it clear that filing lawsuits or other actions probably will push you into bankruptcy which will reduce any likelihood of payment. Expect anger and always stay calm. The worse off you are the more effective this is. Of course you need to be able to make the payment if they agree to accept a discount. Get a complete release signed so they cannot take a second bite at the apple.
2. If there are multiple vendors for a trade you may be able to move between vendors. At one point I had 5 carpet vendors. It was not the cheapest but it reduced cash needs. Of course times were so bad that even though we in effect paid the carpet guys 5 months after the install they all kept installing because we finally did pay them.

The Confidential Guide to Protecting Cash Flow in Difficult Times

3. Cut payroll to the bone and then cut some more. It is amazing what can be accomplished if it must be. Determine work that does not absolutely have to be done and forget about it for the short term.
4. Renegotiate leases and other contracts where possible. See about a rent holiday or giving up portions of your space. If you are not making payments on equipment that is collateral on secured loans or leases put the equipment where it will remain safe from repossession agents. Try to negotiate favorable terms for return or get the equipment working and generating cash flow so you can resume payments.

Conclusions

Horde your cash and dole it out as you must. Having cash on hand will allow you to continue operations and live to see a better day.

- In order to do this you must begin with a realistic plan and financial cash flow analysis.
- Make the deep cuts you need early and quickly.
- Expect people to be angry but you must communicate and maintain control.
- Get trusted advisors to review and to advise you on your plan.

Negotiations take time, do not expect instant results and plan on living with uncertainty. Remember this is an unpleasant necessity in many cyclical businesses and keep your chin up. Survival of your business is paramount. Finally, one day things will normalize and you will begin growing again.

If you have questions, or we can be of service in preparing or reviewing strategies and plans please call or email. Initial consultations are free.

About the Author: Gregory R. Caruso, CPA, Esquire, CVA, is Principal at Harvest Associates a Baltimore based M&A and Consulting Firm. He advises construction related firms including subcontractors, suppliers, engineers, etc. on cash flow and business management matters including turn-around situations. He has deep commercial project management experience and spent 10 years as an owner running a substantial local homebuilding company through a difficult recession. Additionally he has 20 years transactional experience as a broker, advisor, and principal. He is author of the book 11 Secrets to Selling Your Business. Greg can be reached at 410-507-5441 or www.harvestbusiness.com, gcaruso@harvestbusiness.com

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The Confidential Guide to Protecting Cash Flow in Difficult Times

Disclaimer: This guide is not legal, tax, or accounting advice. It is a starting point explanation of techniques that have been used successfully by myself and others in the past to manage and overcome cash flow problems resulting from revenue drops in cyclical businesses. Any of these steps or actions may reduce your credit availability from creditors and may impair your credit rating both personally and for your business. I make no assurances of success and provide no representations or warranties that these techniques will work for you. In all cases you are advised to review your plan with your trusted advisors including a local CPA, and local attorney knowledgeable with the laws and customs in your jurisdiction.