CASH: Getting It When Needed
A Predicted Money Crunch Emphasizes The Importance of Pre-Planning For Company Working Capital Needs

The issue of how quickly the economy—and particularly the construction industry—will bounce back is still in the debate stage. But on one matter, a consensus seems to be growing: a money crunch is in the offing.

With interest rates uncertain along with the inflation question, it's expected that most banks will insist on keeping most of their loans as short as possible. For the wall and ceiling contractor this means there may be some real trouble ahead in raising anything but very short-term capital.

Even some healthy companies may experience difficulty in getting short-term money.

Because a contractor's need for extra funds may arise suddenly—whether through a collections problem, a deterioration in the cash flow that went unnoticed, or an unexpected opportunity to expand or take a big job—the time to plan and arrange for obtaining additional working capital is now.

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Should a bigger squeeze on loan money occur, a contractor might find that the reliable credit lines he enjoyed in the past are no longer available and he might therefore need to employ different strategies or open up new sources.

Most contractors feel that they have tried all the methods of raising capital that exist, but careful attention to the internal and external possibilities for maintaining a maximum money position may disclose options that were never before fully considered or used.

Because a prudent contractor makes every effort to work within his own capital and thus avoid the need to pay interest rates on borrowed money, the most obvious source for building needed working capital is from current operations.

Here, briefly, are some good management practices, most of which are well-known but occasionally brushed over in the day-to-day pressures of doing business:

1. Bank Accounts: Avoid keeping too much cash in the checking account and put the excess to work. Where applicable, consider consolidating bank accounts into one and thus reduce the service charges or reduce the minimum balances required.

2. Accounts Receivable: If possible, toughen up credit and collection policies to increase cash. On
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small jobs, push for a partial payment before starting.

3. **Accounts Payable:** Seek longer terms from some suppliers, especially those who don't provide prompt payment discounts. For many products it's now a buyer's market so press for concessions—price, discounts on cash payments, freight allowances, quantity discounts, etc.

4. **Inventory:** Reduce for the time being the purchase of materials not really needed. Hold off on payments to as close to payment time as possible—without sacrificing prompt payment discounts. Consider equipment leasing through a major finance company for items with a price tag too high; the interest is higher but this penalty may be offset by need, the elimination of a compensating balance, and the fact that the arrangement won’t effect borrowing from a bank.

5. **Work-in-Progress:** If a speed-up proves economical, try to complete the job and obtain payment sooner.

6. **Fixed Capital:** Consider selling off anything not needed such as machines, land, buildings, office equipment, etc. Investigate the possibility of renting equipment not being used to other contractors.

Although virtually every contractor mentally estimates his future cash expectations, the human danger of optimistically “rounding off” his estimates or forgetting an important cost item—is a real one. For this reason, it is good management practice to commit cash planning to writing, at least on a monthly basis.

A written cash forecast plan leads to better cash management, promotes a more realistic borrowing program, demonstrates to lenders the ability to plan ahead, and shows where the company is headed.

And it will signal when and how much in additional funds beyond internally generated cash are needed. A little pre-planning can make a trip to the money market less nerve wracking.

Especially, in a period of tight money when a contractor may require a loan for longer than a very short-term period it is more important than ever to be prepared to explain and document to a lender the need for the loan, how it will be used, how it will be repaid, and how the business will benefit.

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In addition to the usual profit and loss statement, the most recent balance sheet, and the loan application form, it is a good idea to prepare a cash forecast usually for a year along with a projected financial statement for the period that the loan will cover.

In fact, the more financial data that a contractor can provide the greater are his chances for obtaining a loan—and this hold true in good or bad money times and regardless of the type of loan: secured (collateral posted) or unsecured (usually for less than one year and primarily based on the principal’s guarantee).

An audited financial statement is a definite plus because it serves as assurance to the lender that the report is true and unbiased.

Another valuable strategy for a contractor to follow is to calculate and make available to the lender commonly accepted ratios for the company, enabling the lender to make a better evaluation of the application. These ratios include:

- **Quick Ratio** (acid test) — current liabilities divided into cash and receivables.

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Expense to Sales Ratio — net sales divided into the amount of each type of expense.

Working Capital Ratio — current liabilities divided into current assets.

Inventory Turnover Ratio — average inventory divided into cost of sales for the year.

Accounts Receivable Turnover Ratio — net credit sales for the year divided into trade receivables at the end of the year times 365.

Net Worth to Total Debt Ratio — total liabilities divided into net worth.

Because the information desired by the lender depends on the kind of loan and the type of collateral being used, a contractor seeking a loan should also be prepared, if requested, to provide accurate information on some of the following items:

1. Inventory: What is the condition and age of existing inventory? How much is on hand . . . unusable? How much money is tied up in inventory . . . too much . . . too little?

2. Assets: What is the value, type, age, and condition of equipment, and building? What is the company depreciation policy . . . details on any mortgages or conditional sales contracts?

Title Insurance

In most situations where such coverage has been granted the title insurance company has secured a personal indemnity from the builder. Thus it is in the best interest of the builder to cooperate with the insurance company and settle claims for as small a figure as possible. This goal is best accomplished by concealing the insurance company’s involvement, and feigning bankruptcy.

The sub-contractor’s attorney must appraise himself of the policy protection afforded the construction lender before entering into any negotiations for settlement.

Perhaps a more direct approach would be to explore with the title insurance companies the possibilities of a form of coverage for the sub-contractors. On the surface it would appear that the construction lender, the sub-contractor and the title insurance company granting affirmative mechanics and materials coverage have a common goal . . . to see that the construction monies advanced are spent only on the job in question.

The construction lender wants the job completed, the title insurance company wants all funds disbursed to be spent on the job insured and the sub-contractor wants to be paid for work he performs. With so many common interests, a system could be developed whereby the title insurance companies could directly insure the sub-contractor he would be paid in return for sub-contractor certifications that he has been paid.

The high rate of defaults across the country is evidence of the fact that some changes in the system are necessary. In times of skyrocketing costs everyone needs to be assured that funds will be disbursed in a timely fashion. This would seem to be the proper time to institute changes in the system that will benefit all parties in interest now and in the better days ahead.
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3. Current Information: What is the status of insurance coverage . . . tax obligations . . . work backlog . . . accounts payable . . . accounts receivable? What are salary levels for principals and officers of the company? How many employees in the office . . . in the field?

4. Future Information: What, if any, are your future investment . . . acquisition . . . plans? What is the status of future sales, contracts, work coming up? How much cash does the company expect to receive, spend for a given period, usually a year? Are there any retention or delayed payment problems looming?

While the above represents probably a mere sampling of the information requests that a lender could make in evaluating a loan application, it is important to remember that the final decision is based on the lender’s measurement of the contractor and of his company — balanced against money availability for the loan itself.