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Cash Flow Forecasting in the Construction Industry

Running a Better Business Series

Trimble® Construction

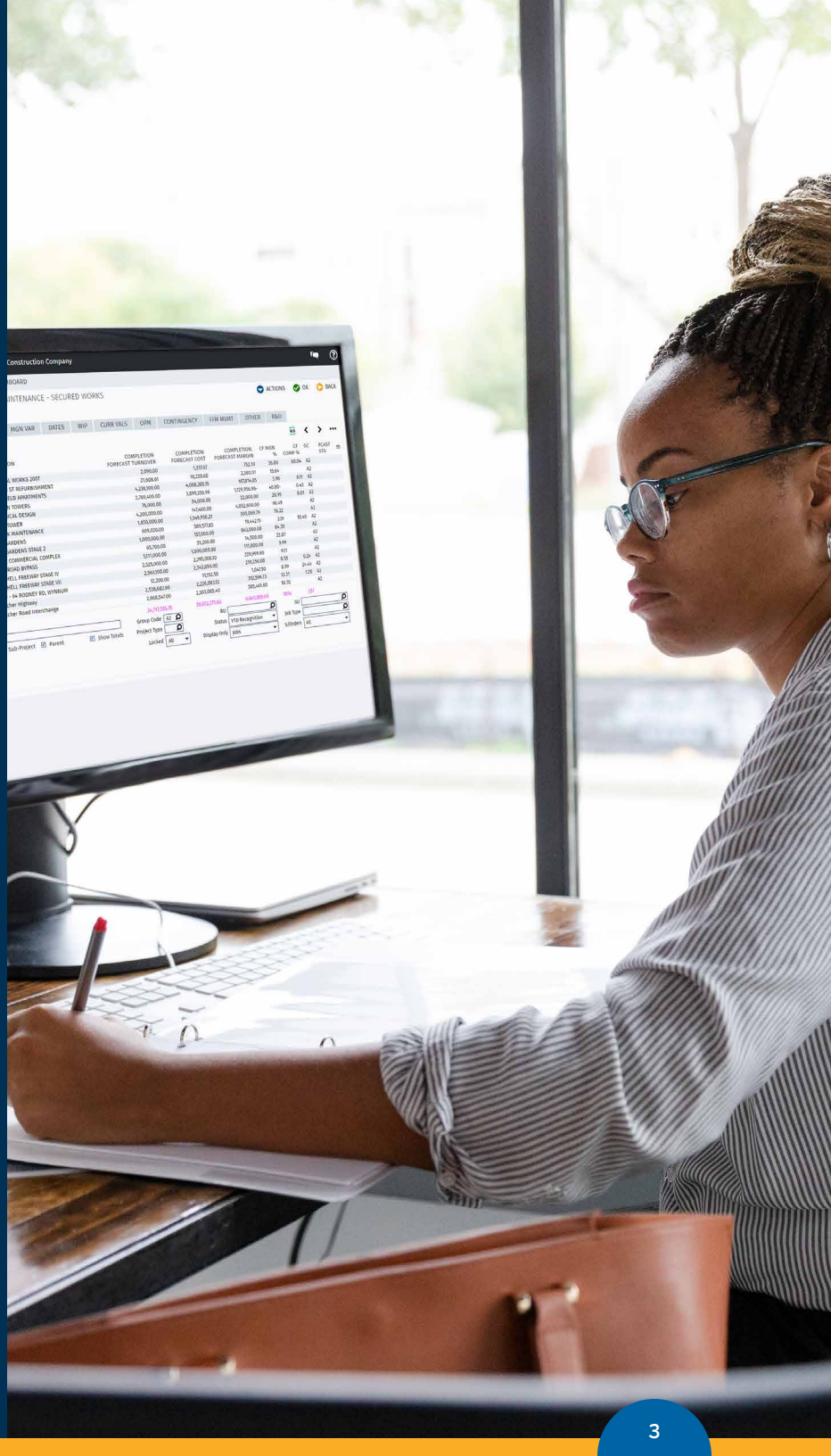
This paper discusses the fundamentals associated around the need to aggregate project level information, and the required business and project cash flow control, integration, and automation options that construction companies can implement to accurately and efficiently forecast cash flow.

The unique challenges of building cash flow forecasts in the construction industry

Any company that can't accurately manage and forecast its cash flow is potentially headed for troubled waters. But the unique challenges and complexities with the construction and engineering sector make cash flow forecasting essential.

Taking into account that project durations vary from days to years; broad contract scope of work; variations to scope; and logistical, sequencing of tasks and conditions that can defy belief-how do you make sense of it all?

It's vital that companies have the capability to build operating cash flow forecasts, project by project, to ensure that working capital requirements are known and provided for. That way they can meet the ongoing payroll, supplier, and subcontractor commitments and support service payment obligations.



Few sectors enjoy the luxury of immediate payment, but the construction industry faces greater complications with progress claim preparation and submission deadlines and varying substantiation requirements, combined with variation and claim negotiation getting in between the ‘doing’ of the work and finally getting payment.

Even the largest construction company can tap out its cash reserves when underlying project revenue and cost forecasts are inaccurate and true project performance is not aligned to the project cash forecast.

Insufficient cash reserves or limited access to additional working capital can create a ‘perfect storm’ which often leads to a higher rate of insolvency and bankruptcy in the construction industry than many other industries.

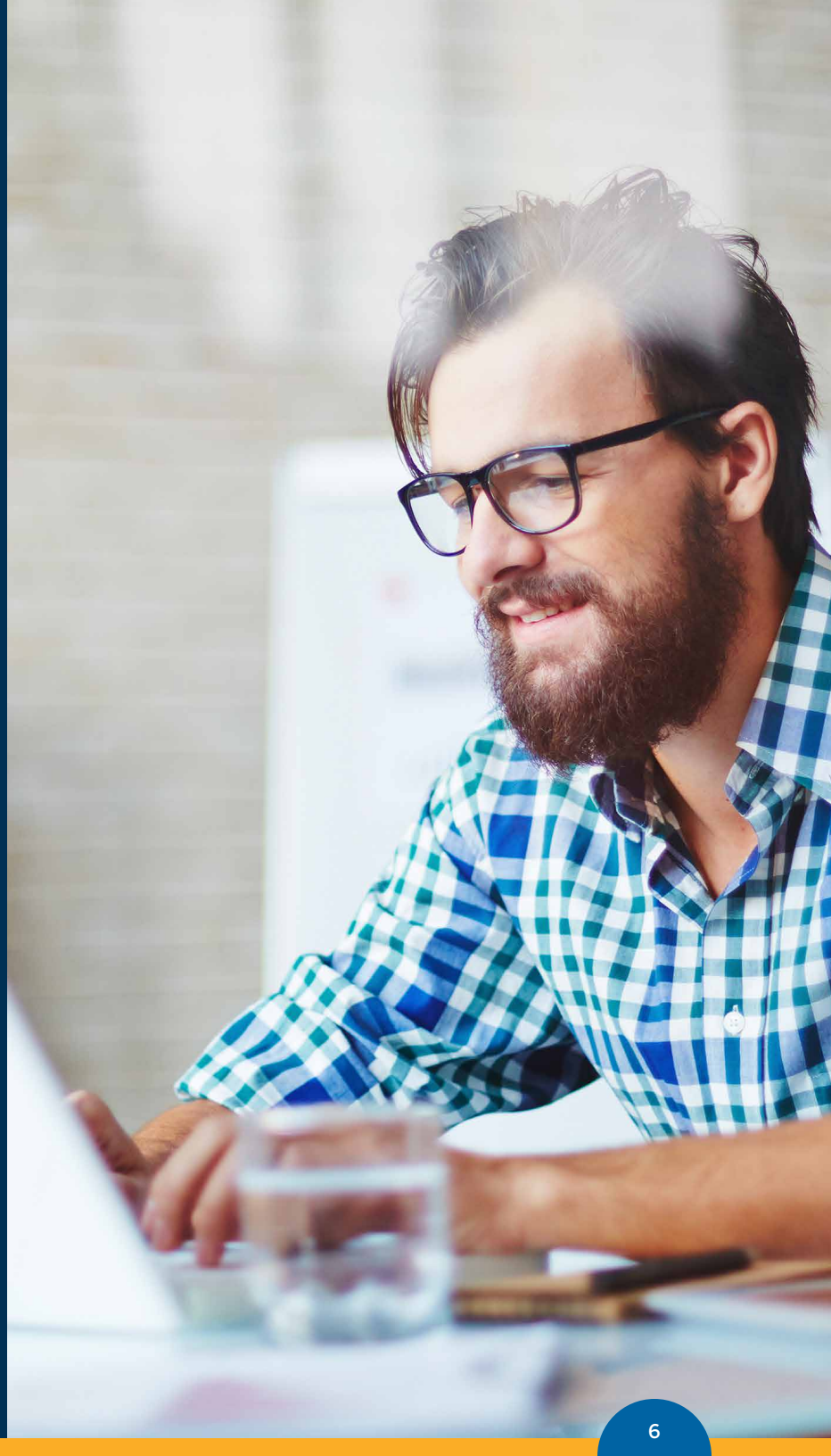
For any construction company to be profitable and stay profitable it needs sound cash flow management and project performance measurement processes in place.

Cash flow —a view into the future

Construction companies need to fully understand their future cash position and potential funding needs to ensure that they are on track to achieve current business goals and objectives. A business process model that integrates all operational and support activities to validate the projected cash flow forecast is required for success. Many companies find that a rolling enterprise cash flow forecast gives management the tools to assess project performance and better manage commercial risk and opportunities.

Requirements for Efficient Cash Flow Management

1. Cash flow forecasting integrated to Work in Hand forecasts and controlled by ForecastFinal positions.
2. New Work opportunities that can be factored into the Cash flow forecast.
3. Automation options based on default cash ‘lag’ defaults.
4. ‘S’ Curve-based cash profiling options, particularly for New Work forecasts.
5. Forecasting and integration capability for nonproject, income, and expenses typically relating to business support services, taxation, and capital management.
6. Flexible reporting and analytical tools to focus on deviation management and continuous improvement in forecasting skill sets.



Building cash flow forecasts

Each project will typically have these three components:

1. Original Budget
2. Execution and resource plan
3. Cash flow forecast

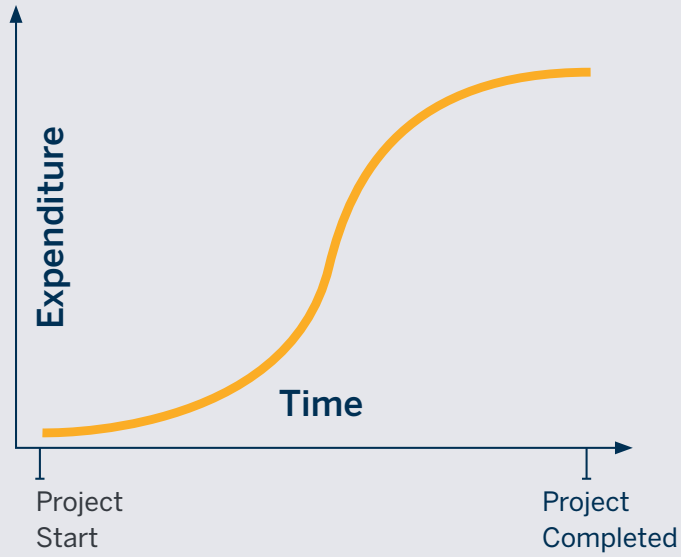
Throughout the life of a project, however, many things can change that can directly impact the original cash flow forecast. Managing that change commercially is typically a challenge, but making a financial assessment of that change and updating the cash flow forecast is critical. Companies need to know quickly what has changed, why it changed, and what is the overall impact for the project, the business unit, and the overall enterprise.

Prudent cash flow forecasting

Achieving expenditure in line with a forecast cash flow is not always easy and can potentially be made more difficult by poor cash flow forecasting in the first instance.

The rate of expenditure on a building project tends to start slowly, increase rapidly as the project progresses, and then plateau towards the end of the project. This phenomenon is illustrated by an 'S curve' graph. This expenditure pattern should be taken into account when forecasting.

Typical pattern/rate of building project expenditure



Source: Capital Works Management Framework, Department of Housing and Public Works, Queensland Government

Time-phased planning helps improve validation and accuracy of forecasts

With money constantly coming in and out of the business, directed to different areas of the project, an efficient approach to allocating costs over time makes sense.

The greatest benefit of working with a time-phased cost budget baseline is that project forecasts are more accurate, with improvements also seen in validation and efficiency.

Rolling forecast capabilities mean reduced cycle times and an idea of the latest financial standing of the project at any given time.

Delivering better business results through integration

Cash flow forecasting is not new/ but fully integrated enterprise software systems designed to meet the challenges of the construction industry are. These systems effectively take the task of forecasting cash flow from complex high-risk, and error-prone systems and activities to an integrated, logical, and standardised process that just makes sense in the contracting world.

As we've seen, the key to delivering better business results is the deployment of integrated business forecasting tools to effectively manage and analyse the financial position.

There are some software vendors in the market claiming their solutions do cash flow forecasting. When they can, they are not necessarily built to meet the unique challenges of the construction industry.

Furthermore, cash flow management tools and processes developed outside or on the periphery to a company's core project control and financial management business systems will not be integrated and simply will not deliver the accuracy and integrity that an organisation requires to sustain profitability and growth.

Viewpoint Jobpac Connect™

About Jobpac Connect

Jobpac by Trimble Viewpoint is an integrated building construction software solution that brings your real-time financials, projects, plant and equipment, and payroll data into one comprehensive system.

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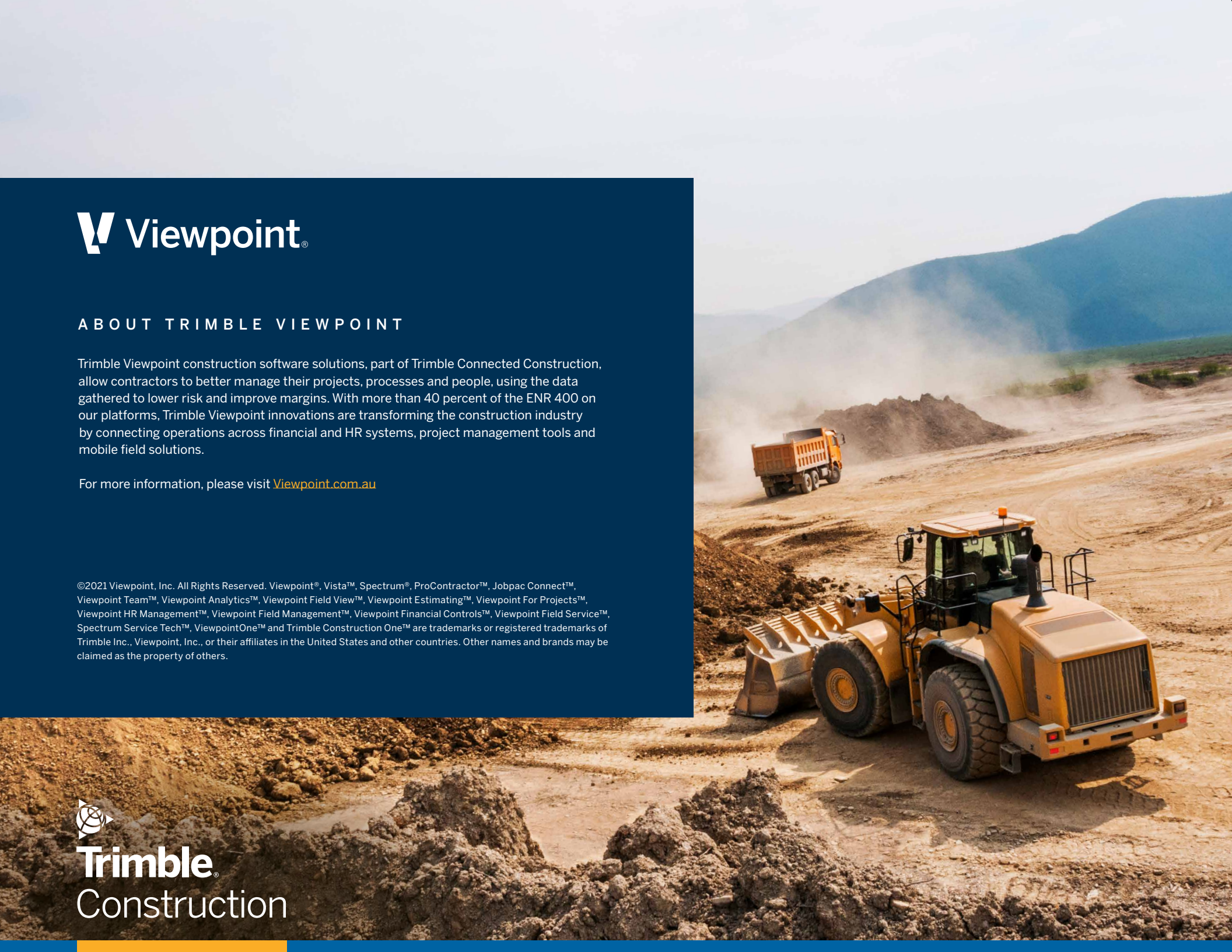
ABOUT TRIMBLE VIEWPOINT

Trimble Viewpoint construction software solutions, part of Trimble Connected Construction, allow contractors to better manage their projects, processes and people, using the data gathered to lower risk and improve margins. With more than 40 percent of the ENR 400 on our platforms, Trimble Viewpoint innovations are transforming the construction industry by connecting operations across financial and HR systems, project management tools and mobile field solutions.

For more information, please visit Viewpoint.com.au



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