

Cash & Capital

BY GORDON COPE

The key to successful business growth means sticking to the principles of money management and planning for opportunity.

ILLUSTRATION BY REGIS LEJONC

FOR MORE THAN SIX DECADES, THE CHARLTON & HILL Group has supplied local commercial clients with metal fabrication, HVAC, roofing and structural steel services. Its staging area, the North Industrial Park in Lethbridge, is covered with a wide variety of formed metal – tanks, platforms, catwalks, trailer skids. One thing you won't see is loads and loads of raw materials. "We have some sheet stock and other commonly used materials on hand at all times, but not a lot more," says Don Clark, vice-president and CFO at Charlton & Hill. The company closely manages its inventory to reduce the level of untimely cash outflows. "You can have all the materials you need for a project delivered on day one, or you can have them delivered to the site with payment terms that work to the job," he says. "Instead of sitting in the yard for six months, you can stage the deliveries."

AT START UP, THE CASH TO PURCHASE inventories and equipment, meet payroll and cover overhead usually comes from initial investment sources. For an established business, however, the majority of those needs must be met by cash flow. Unfortunately, a number of variables can interrupt – or even choke off – the flow of dollars and quickly put a company into a bind. Cash flow is a top priority for Clark and his staff of 130. “The risk you can have is recording profit but being cash poor,” he says. “You’re paying everyone – employees, suppliers – but you’re drawing on your line of credit. Ideally, you want to match inflows to outflows.”

Developing a sound strategy is the focal point to managing cash flow. It doesn’t have to be complicated, but it does involve a coordinated effort between negotiating the right contract, keeping your staff busy year round, managing inventory, weighing the creditworthiness of your clientele and collecting receivables.

THE FIRST ELEMENT OF A SUCCESSFUL cash flow plan is negotiating a contract that suits your needs. Edmonton’s Cavan Contractors Ltd. specializes in building hospitals and schools. The company has operated for 34 years and conducts about \$30 million in work annually. “It can take six months to two years to do a school,” CFO Cal Phare says. He recommends companies negotiate other arrangements to ensure they can maintain regular cash inflows. A contract that delivers an initial deposit up front is better, but Phare recommends ‘paid-on-progress’ arrangements, in which the contractor is remunerated on a regular basis.

Regardless of the contract, punctual invoicing is critical. “You have to bill in a timely fashion and you have to collect in a timely fashion,” Phare says. “The key is organization. You have to develop a good team, right from administration, finance, project management to field personnel.”

Complying with a client’s paperwork requirements is critical. “They may want backup documentation – timecards, progress schedules. You can lose 30 days if you don’t have them ready,” advises Charlton & Hill’s Clark. Unlike manufacturers that can produce goods during slow months and



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warehouse until the busy season, contractors need to have personnel and equipment in action year round. “People are our number one overhead,” says Phare. “If you have five superintendents, you want to keep them all busy and making money,” he says. “It’s the same with equipment; you’ve got six Cats in the yard, you want them moving dirt.”

Cavan Contractors mitigates the issue of idle equipment by leasing, rather than purchasing. “We want to be careful with equipment – you can get long-term leases but no work to pay for them,” says Phare. The company’s approach leaves more cash flow available for payroll. “We want to maintain good personnel to perform at a high level, rather than bricks and iron.”

TO KEEP PEOPLE BUSY, A CONTRACTOR tries to time projects to overlap. Unfortunately, cold winters mean downtime for a lot

of construction companies. Keith Brooke is the principal owner of Unitech Electrical Contracting Inc. With 75 employees, the Calgary company subcontracts between \$15 million and \$20 million worth of business in offices and malls annually. “Normally, January and February are quiet,” he says. “Last year, I was loaning out labour to a competitor.” So Brooke decided to reduce winter downtime. He focused on cultivating large commercial management companies which need electrical contracting work done year round. “We’ve picked up a lot of tenant work,” he says. Electrical contracting has the advantage of largely being indoors; other trades aren’t so fortunate. “At 30 below, there are not a lot of guys out doing roofing,” says Clark. Charlton & Hill has diversified its trades in order to keep a percentage of employees busy, no matter what the weather.

Without a doubt, collections are the most important aspect to cash flow. “The biggest thing for us is keeping on top of receivables,” says Brooke. “I get receivables every two weeks and sit down and go through them. They’re listed as 30-60-90 days, and anything that hits 90 days, that’s a red flag. Rather than send a letter that gets tossed into the round file (garbage can) next to the desk, we do a personal phone call, ‘can we pick up a cheque this week?’ It’s old fashioned, but it works.”

FOR ANY COMPANY WITH ASPIRATIONS to expand, growth places yet another burden upon cash flow. “As you grow, you increase overhead and your cash flow needs are greater,” says Phare. “You have equipment requirements, systems, all of these sorts of items.” Just as in managing cash flow, a strategy is needed to guide growth. It involves choosing how you want to grow, picking the best source of money to finance it, managing the risks, and knowing when to say no to certain opportunities.

When a business is established, it essentially grows by building a new client base. But for an older business with long-standing clients, other methods, such as growing internally by adding services, are options. “We’re not traipsing around the countryside looking for new business,” says Clark. “We

Empowered Business

Charlton & Hill Group has a unique way of dealing with outstanding invoices – everyone in the company is a bill collector. “We provide business literacy to all employees,” says Don Clark, vice-president and CFO. “Our guys can issue invoices and collect funds on site.”

This unusual approach arose nearly 10 years ago, when company employees began looking for a better way of operating the company. “They found this method called ‘open book management’ and presented it to Charlton & Hill,” says Clark. “It’s a management technique that grew up some years ago in Springfield, Missouri, when some people bought out an old International Harvester plant that was bleeding red ink,” he explains. “They needed to run it differently, so they thought, if everyone knew all about the business, they could collectively use ideas to improve the profitability.”

They called it the Great Game (www.greatgame.com), and the tenets are that everyone know and teach the rules, keep score, and provide a stake for success. “This way, people have a better idea how they influence the outcome,” says Clark. “If we do well, we all share.”

At Charlton & Hill, the game begins with everyone participating in the business plan. “Cash flow is integral to the game – ‘cash is king’ is a mantra to all of us,” says Clark. “We look at receivable collections, terms of contracts, delivery of materials, payment of subcontractors, pricing of steel.” Throughout the year, the staff meets every two weeks to review financial data. “We discuss issues related to cash flow and costs and keep people aware of how they affect the business.”

Armed with financial information and the responsibility to act upon it, field staff can interact with clients directly. “Let’s say the price of steel goes up, or certain types of steel are scarce,” says Clark. “We advise our customers accordingly. We can substitute a less expensive steel or reschedule work.” Because they are also responsible for recording their own time and materials usage, invoicing becomes that much more efficient. “A foreman has 10 or 15 guys,” says Clark. “Did they use one or two rolls of tarpaper, or replace a blower or do duct work? The guys are accurately recording that on their sheets, in a timely manner.”

As for bill collecting, while one might think sending a brawny roofer to enquire about an overdue invoice would be effective, Charlton & Hill eschews such tactics for more customer-friendly approaches. “Let’s say we install a new furnace,” says Clark. “Guys have time cards filled out and materials listed right there in the field. They can say, ‘How would you like to pay?’ Sometimes the client pays that day.”

The company benefits because invoices are submitted more promptly and payment arrives sooner. Employees receive bonuses if their efforts show up as extra profits. There are drawbacks to open book management, however. “This approach is not for the faint of heart,” says Clark. “It’s like the emperor with no clothes. Everyone knows what we do and where we make our money.” But in the end, it’s a small price to pay for increased cash flow and increased profits, he adds. “We’re dedicated to developing a smarter business.”

Increasing the value of the workforce through training also helps to increase cash flow. “That’s where we grow,” says Phare. “Our people get more trained, more successful and move into higher positions.” In Alberta’s current red-hot business climate, lack of skilled labour, not the lack of jobs, is the limiting factor.

“We’ve had to say no to work,” he explains. “We don’t turn our long-term clients down, but sometimes we see a tendered project

that’s our niche, and we elect not to tender.” An established company can also grow (and improve cash flow) by carefully evaluating the types of work available. “About 80% of our work is bid and spec work, and about 20% service work for big property management companies like Bentall (Capital),” says Brooke. “We want to reverse our numbers so that we do 80% service work and 20% bid work. With bid work, you’re always chasing your money, whereas with service work there’s no hold back and you’re paid in 30 days.”

GROWTH NEEDS CASH – CHOOSING THE right, or wrong source of capital can have a great influence on cash flow. Probably the best way to minimize impact on cash flow is by building up a healthy nest egg. “We had retained earnings of \$2 million,” says Unitech’s Brooke. “It bought us comfort, and when the banks looked at us, we got a high line of credit at a very good rate.”

Self-funded growth through cash flow has the advantage of eliminating interest payments on loans. “If you manage cash effectively, you can do small growth out of internally generated cash,” says Clark.

However, most companies rely upon traditional banks for a large part of their month-to-month financial needs. “Banks finance against inventory and accounts receivable – that’s your line of credit,” says Steve Brown, manager of the federal government’s Business Development Bank of Canada’s (BDC) Calgary North branch. “Chartered banks take little risk because assets can be converted to cash, so borrowing from them is relatively cheap.”

When a new job is an order of magnitude larger than previous work, however, other financial sources need to be examined. “You can go with joint ventures or private equity,” says Clark. He cautions these forms of funding require qualified legal and accounting advice prior to signing the contract. “Otherwise, it can surprise your (traditional bank) lender. It can put stress on cash flow and financial relationships.”

Brown notes the BDC offers various products aimed to assist larger financing needs. “It’s called subordinated financing, or mezzanine financing,” he says. “A higher

capitalize on existing customers to find new services we can offer them. We are constantly communicating with customers to find the issues they’re facing,” he says. “Then we add new services that have been requested.” In this fashion, Charlton & Hill, which began with roofing and sheet metal, added heating, air conditioning, metal fabrication services and then structural steel. “We’ve had steady, conservative growth over the last 10 years, in the order of 5% to 7% annually.”



interest rate is involved, around 16% to 22%, so if you borrow \$1 million at 16%, it's going to cost you \$160,000 per year," Brown outlines. "But that working capital may allow you to do another \$2 million to \$3 million in sales. If you have high gross margins, you might make an extra \$400,000. For the cost of the extra \$160,000 in interest, you are making a good investment."

All growth comes with risk, and directly impacts cash flow. Probably the greatest risk is non-payment. "We've been operating for over 63 years, and every once in a while you get an 'oops'," says Clark. Charlton & Hill try to keep non-payment woes below 1% of business by performing due diligence. "Look at credit reporting. It can provide data that gives you comfort in advance of being paid. But remember, it needs to be done before you send the guys down the street in the truck."

OCCASIONALLY, HOWEVER, EVEN A VALUED CUSTOMER falls on tough luck. "We have a lot of agri-food around Lethbridge," says Clark. "It's a robust, strong, honest group of people, but sometimes you can have tough years. You can't just bail out on them," he adds. "You can have systems and controls in place, but sometimes reality hits and you have to help a customer out."

For established businesses seeking further information on managing cash flow in order to grow, the Business Development Bank of Canada and Alberta Treasury Branch offer a wide range of financing products, planning and services. But nothing beats having professional advice on staff. "Having a good finance guy is very important," says Phare. "Not having qualified people is a mistake."

In the end, each company has to seek out a unique combination that works for it. Phare recommends diversification of your client base in order to minimize nonpayment risk. "Don't depend on one cheque, one source." Clark suggests maintaining and managing a good relationship within the regular lending community. "Give them the good news and the bad news. That way, when you need funds for a larger job, they're receptive. Don't just call the bank when you need them." □

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