



State What's More Important – Profitability or Positive Cash Flow?

George, a masonry contractor, claims that Profitability is the most important ingredient of a construction business. Meanwhile, his brother, Abe, a drywall contractor, insists that cash flow trumps everything.

Which factor do you think is the most important for your business?

George studies his Profit and Loss Statement (P&L) constantly and bids only on jobs where he can make a satisfactory profit. He has an opportunity to bid on a big school job, for which he needs bonding. However, the bond underwriter declines to issue the bond. Why? According to the bond agent, the surety doubts that he will have adequate cash flow to make it to the finish line on that job. Too much can go wrong. George is beside himself and points to a history of consistent profitability in his business. Yet, the surety determines that, due to an inadequate line of credit and insufficient working capital, George might run out of cash midway through the job.

Meanwhile, Abe feels that if he is “flush with cash,” then everything will be OK. Abe takes on unprofitable work to help him cover some overhead during a lean time. He is always careful to predict when money will come in and when it needs to go out. Unfortunately, after being in the business for twenty-some years, Abe wonders why he has never been able to set money aside for retirement. He finds himself envious of fellow contractors whom he knows made a killing on jobs where he only broke even. His business keeps going, but it's not really going anywhere.

One way to think of cash flow and profitability is like this. Cash flow is the lifeblood of your business. Profitability is the air you breathe. Blood and air. One without the other cannot sustain you for very long.

How does a contractor ensure that there are both adequate cash flow and sufficient profitability? One important tool, in addition to diligent review of Company Balance Sheets and Income Statements, is the use of Projections to estimate/predict streams of revenue/expense/cash. Consider projecting Revenues as well as job costs and overhead. Consider projecting both Profits and Cash Position for the weeks, months, and years ahead. Do a Sensitivity Analysis to determine the effect of various assumptions on cash flow and profitability. Analyze the risk factors of being too concentrated or too spread out, whether geographically, by type of work, or by customer type.

Quite a few CFOs and Controllers are quite capable of preparing these projections. Many successful companies utilize the services of their CPA (L&G has assisted numerous clients with these projections) to prepare, review, or advise on the projections.

The important thing is to think forward to avoid future crises. Resist the temptation to linger in the economic malaise that's been going on and the effect it's had on your business. Instead, think about how to predict your company's future profitability and cash flow. Then, get the projections done and revise these projections weekly or monthly as circumstances change. Finally, make management decisions and take effective action to create favorable outcomes in the future. It's hard work, but it's rewarding. And it all starts with projecting BOTH profits and cash flow.

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