

CASH MANAGEMENT FOR THE DESIGN FIRM

FRANK A. STASIOWSKI

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To my mother, Kathleen (Stasiowski) Worthington, who taught me to balance my first checking account, who helped me with my first paper route, and who has always stood behind me in every decision I have made.

PREFACE

Cash flow is so vital to the existence of a firm that it must be constantly monitored, and requires careful planning. A design firm lives or dies on its ability to manage cash above all else. For this reason, Chapter 1 provides an overview of cash management techniques.

Project budgeting is an immediate outgrowth of cash management because, ultimately, projects bring in cash. Chapter 2 provides a budgeting system to apply to projects, and suggests corrective measures to prevent costly overruns. Quite naturally, the price you charge the client directly affects cash flow as well, and Chapter 3 explains how the project manager and financial director develop profitable project pricing structures.

The next step after budgeting and pricing is controlling costs. Two full chapters are devoted to controlling project and overhead costs—Chapters 4 and 5. Recognizing the danger signals of potential cost overruns is perhaps the biggest challenge of a firm's financial leader.

Receiving an influx of sufficient capital to maintain operations depends greatly on the structuring of a firm's invoicing and billing process. Chapter 6—Getting Paid provides guidance on ways to improve collections and reiterates the significance of healthy cash flow.

The firm cannot rely on individual project plans alone; design firms must have an overall company planning and monitoring system, such as that outlined in Chapter 7—Planning and Monitoring Performance. A standardized contract format is equally important in providing an overall consistent approach to project budgets, prices, and cash management. Chapter 8—Contract Negotiations explains the most profitable contract types, and the principles of negotiating.

Financial controls are implemented to ensure that cash

flow is directed through the proper channels—and financial controls include financial reporting systems, the purchasing process, capital equipment acquisitions, and internal financial controls. These subjects are addressed in Chapters 9, 10, 11, and 12, respectively.

The final chapter looks at who the financial manager is within the structure of the design firm. Whether the financial manager is an employee charged specifically with the sole task of managing a firm's finances or a managing principal controlling finances along with myriad other responsibilities, the role remains the same. The "financial manager," as such, doesn't have to perform each and every task, but rather is the individual who weaves the intricate elements of finance together into a coherent force driving the firm's financial stability and profits forever upward.

FRANK STASIOWSKI

*Newton Massachusetts
May 1993*

AUTHOR'S NOTE

For seventeen years, Practice Management Associates has been leading workshops on finance for principals of architectural, engineering, and planning firms. As these workshops evolved, it became apparent that there exists a strong need to disseminate even more knowledge on financial techniques to managers with nonfinancial backgrounds. The principals of smaller firms in particular need this information in a format they can readily absorb and utilize immediately. This text was designed to meet that need.

Before beginning, please note that the term “financial manager” is used frequently throughout the book. While many firms have a specific individual assigned to the role of financial manager, this term is meant to denote anyone within the firm who handles the financial management duties—be it managing principal, partner, or chief executive operator.

Exercises appear at the end of most sections within the chapters, helpful checklists appear throughout, and final examinations at the end of each chapter. These exercises and examinations can and should be used to reinforce the text. These exercises are in the format of multiple choice questions, true or false statements, fill-in-the-blanks or discussion problems. For multiple choice questions, it is necessary to choose the most correct answer from the choices provided, based on information given in the text. For true/false questions, determine whether the statements given are true or false, and circle either “T” or “F.” Fill-in-the-blanks are self-explanatory. There are also some instances where you will be asked to examine your own firm’s financial management systems. While most of the quiz and test material is presented for reinforcement of the principles presented, be sure to fully research and complete all of the questions and challenges we

offer. This will allow you to piece together a thorough overview of your firm and its cash management needs.

When you complete this text, you will not only have learned how to manage cash flow of your firm, but you will, if you fill out all of the questions, exercises, and examinations, gain a clearer picture of where your firm is at today and where it is headed for the future. Avenues for improvement will become evident as well, and you'll know where to turn to initiate those changes, based on the information offered here.

Successful firms have one common trait: they know where they have been, where they are going, and how they are going to get there. Their principals understand that design and engineering excellence alone do not create profits. Project profits are generated by tough project management that fits into an integrated firmwide cash management system. When regularly and systematically applied, the tactics outlined in this book on financial management will result in increased profitability at minimal cost.

Some of the techniques described in this book will appear overwhelming to those not familiar with them, yet they are relatively straightforward when worked through once or twice. By religiously practicing each step of financial planning outlined here, firms that previously operated on a reactive basis will find new ways of increasing profits by being able to track what is really happening with the firm's finances.

I trust you will examine the concepts presented here and begin to incorporate them into your daily practice. They are basic, easily used, and they work. The rewards are there if you take the time to plan.

FRANK A. STASIOWSKI

President, Practice Management Associates, Ltd.
Publisher, Professional Services Management Journal

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MANAGING CASH

Chapter Summary

- Suggestions for obtaining a line of credit
- What to do if you are rejected by a bank
- Other financing sources available for equipment loans
- How to obtain additional financing with employee stock ownership plans (ESOPs)
- How to prepare a forecast of cash receipts and disbursements
- Bank services available to improve cash management

Cash Flow and Success

Proper management of a design firm's cash reserves is extremely important, and keeping a positive cash flow in good times and bad is essential for continued existence. Cash flow is so vital to the existence of a firm that it must be constantly monitored. While the person in charge of finance is closest to the cash situation on a daily basis, the proper management of cash requires more than merely reacting to situations as they occur. It requires careful planning to ensure the necessary cash available when needed, while minimizing bank borrowings or disturbing of short-term investments.

1.1 CASH FROM CLIENTS

As a result of the banking crises of the early 1990s, there is increasing need to recognize that the primary source of cash in design practice is your clients. It is impossible to place too much emphasis on improving the negotiating and contracting skills of each design professional in your office through constant training and attention to these two vital areas of

practice. A few rules are in order to set the stage for the balance of this text:

1. *Check Credit on All New Clients.* In today's world this simple act is a cash preserving strategy protecting you from investing in a future bad debt. It is bad business not to do a routine credit check. Even you are checked when you purchase more than \$50 worth of merchandise at a store.
2. *Get Money Up Front.* No design firm can afford to finance its clients. Thus, every client should be asked for a two to three month advance payment to be credited to the final invoice on a project. If a client won't give you money in advance, you may be receiving a "telegraphed message" about that client's intentions once you start working.
3. *Learn How to Negotiate.* Study, study, study, study, study, study, study, and when you are done, study more. Then practice negotiating tactics everywhere. And if you don't like the heat, get out of the kitchen and put someone in who really enjoys negotiating and does it well.
4. *Stop Work Early.* When clients don't pay, they are not good clients. Stop work.

Remember, in the ultimate scheme of things, all cash comes from doing work. Put your mind in gear, and put as much creativity into up front cash generation techniques as you put into your design effort. And remember, lack of cash is the primary cause in 92% of all bankruptcies.

1.2 SOURCES OF CASH FLOW ADVICE

When cash is tight there are several outside sources that a firm can use to help with its cash management problems. The principal source is the firm's banker. The banker is usually well experienced in cash management procedures, and sometimes banks will have a specialist on staff to assist customers in improving cash management. If this expertise is to be truly useful, the banker must be thoroughly familiar with the firm and its operations. Most of a banker's clients are probably manufacturing and retailing businesses, which

means that the banker may have relatively little familiarity with firms engaged in providing services. Therefore it will take an effort to familiarize the banker with a professional service firm.

Additionally, because of the savings and loan crisis, banks are exceedingly cautious about lending to firms without marketable inventory as collateral. This means it is even more important today to keep in touch with your banker regularly.

A good practice for the design professional is to keep the banker advised of operations by meeting at least once or twice a year to go over the firm's financial statements and prospects. Quarterly meetings are even better. One thing to keep in mind is that these meetings can be beneficial to both parties. The banker is a good source of marketing information because of membership in the Chamber of Commerce and other organizations as well as associations with many businesses. Often a banker is the first to know about firms moving into and out of the area and has an indication about new facilities being planned in the region.

The firm's outside accountant is another source of assistance in cash management. The CPA sees many types of businesses and is in a good position to make suggestions for improving cash management. During the course of an audit of financial review, the accountant studies cash flow procedures and can draw on his or her background serving other clients to make good suggestions. One thing to remember is that if you ever want to make any significant changes in your accounting procedures, talk them over first with your accountant. The accountant is also a good general business adviser because, through audit and tax work, he or she knows more about your firm than possibly anyone else. The accountant can often make good suggestions from the vantage point of an independent outside resource.

See Exhibit 1.1 for a checklist on utilizing your consultants.

EXERCISE 1.2

Your Use of Consultants

True or False

- T F** The principal source for cash management decisions is a firm's banker.

CHECKLIST FOR UTILIZING CONSULTANTS

YES	NO	
<input type="checkbox"/>	<input type="checkbox"/>	Is your banker adept at cash management procedures?
<input type="checkbox"/>	<input type="checkbox"/>	Does your bank have a cash management specialist?
<input type="checkbox"/>	<input type="checkbox"/>	Does your bank understand how design firm cash flow differs from that of manufacturing firms?
<input type="checkbox"/>	<input type="checkbox"/>	Do you sit down with your banker at least twice a year?
<input type="checkbox"/>	<input type="checkbox"/>	Have you thoroughly utilized your banker as a source for information about upcoming work?
<input type="checkbox"/>	<input type="checkbox"/>	Has your firm ever used an outside auditor?
<input type="checkbox"/>	<input type="checkbox"/>	How closely involved is your accountant in the firm's cash flow procedures?

Exhibit 1.1 There are several outside sources that you can use to help with cash management problems.

- T F** Bankers are generally familiar with cash flow operations in service firms.
- T F** A design firm should meet with its banker once every two years to go over cash flow.
- T F** An outside auditor is another source of assistance in cash management.
- T F** The only real source of cash in design practice is a firm's clients.
- T F** A CPA cannot assist in cash management.
- T F** Clients never pay cash in advance to a design firm.
- T F** It is only important that one person in a firm understand how to negotiate contracts.
- T F** Any changes in accounting procedures need not be discussed with your accountant.
- T F** Your accountant knows more about your firm than possibly anyone else.
- T F** Quarterly meetings with your banker are highly unnecessary.

1.3 OBTAINING A CREDIT LINE

In spite of the banking crisis and a shortage of funds “loanable” by banks, most firms still need a line of credit to support their working capital needs and to help expand operations. Generally, the best time to arrange for a line of credit is when the firm does not have an immediate financial need or when banks are eager to loan money. Unfortunately, you cannot always time your requirements to fit the banker’s needs and that means you will be competing for funds along with everyone else.

It is important to sell the banker like any other client when preparing a loan request. That means the banker should understand the objectives of the loan and have confidence in your firm. The banker must understand how design firms operate and your firm’s position in the marketplace. He or she must learn your firm’s strategy and its strengths and must have full and complete financial information, both current and projected. Most importantly, you need to document how the loan will be repaid. The firm should ask for a revolving line of credit, which means that as portions of the loan are repaid, they are available to be re-borrowed up to the limits of the credit line.

Bankers will generally want security for the loan, which means a pledge of accounts receivable. Usually, the amount of the loan will be determined by the amount of accounts receivable on the books that the banker considers current, that is, less than 90 days old. In that connection, it is important for the banker to understand the difference between a 90-day-old account and a retainer. A retainer is money withheld from the design professional’s invoices to assure compliance with the terms of the contract. Since only a portion of the accounts receivable are paid, the balance remains on the books and should be identified as a retainer rather than as a partially paid invoice that grows older each month. If the firm does not distinguish between the two on its accounts receivable aging report and if the difference is not explained to the banker, he or she cannot be expected to make the distinction. Furthermore, many bankers do not understand the nature of the design profession and the fact that all receivables past 90 days are not potential bad debts. The banker should be made to understand that often a design professional working for a developer, for instance, will not be paid until the developer