

# **BUSINESS "BLOOD CIRCULATION"**

## ***A Brief Introduction on the Construction Enterprise Cash Flow Management***

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Abstract: Cash is the blood of businesses. Without cash, business operation can hardly be achieved; without cash, businesses have no choice but to exit the market field. The importance of cash flow management was revealed.

### **1 INTRODUCTION**

The goal of Business is to gain profit, and construction business has no exception. However, the precondition of gaining profit is to survive. Long-term losses, income over expenditure and not be able to refinance maturing debt often leads to business's bankruptcy. The threats to enterprises survival directly come from the insolvent. Thus, a company's rise and fall doesn't determine by paper profit, but rather by cash flow. Paper income does not reflect the strength of enterprises, enhance cash flow management is the key.

Cash flow is revenue or expense stream due to a certain economic activities that changes a cash account over a given period. Cash is not only the start and end of the fund flow, but as well throughout the whole process of business activities. Cash flow management is therefor, the financial management activities on business activities, investment and financing activities centering on cash flow as well as making revenue

### **2 THE URGENCY OF CASH FLOW MANAGEMENT IN CONSTRUCTION ENTERPRISES**

Construction industry is one of the pillar industries in national economic construction and it is the pilot-based industries for the related industries'

development. Construction enterprises possess large capital investment but project fund arrears seriously; in its enterprise management activities, the cash flow situation is more important than profit and loss. A profit year is not necessarily meaning produce excess cash used for reinvestment in other projects. The sustainability of a project does not depend on whether a certain period of profitability, but on whether has cash for a variety of payment. Once made the expenditure of cash, regardless of consumption or not, it can not be used for other purposes. Therefore, analysis and management of cash flow should be given more attention in business production and operating.

For many reasons, the construction market becomes more competitive, and requiring prepayment construction for construction enterprises becomes a common situation. Pre-payment construction means the investors require construction companies complete a certain parts of the project without giving advance payment; or require the construction enterprise for a pre-paid deposit before the project. Nowadays, pre-payment construction has become an important way for investors to lower capital cost, pass on operational risk, and corporate profits squeeze for the construction enterprise. Many investors even adopted it as its "business principal". Some investor also requires pre-payment construction even if they have enough projects funded. Therefore, pre-payment in fact has become a prerequisite for contracting project and an operation "trap" which is difficult to avoid. The main source of construction tasks determine by competitive bidding, so the

construction enterprise makes their bid at all costs. However consideration on project budget, project cost, and analysis of the recovery doesn't given full attention. The result is that the construction work and value go up, but the benefits slip off. Thus, in the bidding, company should be considered for the contracting the task, without blindly accept the requirement of prepayment construction or infinitely lower prices from the investor's side.

The imbalance between supply and demand of construction market makes up the direct cause of default project fund situation. Some investor making use of the eagerness to contract a project for construction enterprise, transfer the problem of shortage on construction funds to construction companies, forcing a large number of pre-payment from construction enterprise. Most construction companies apply extensive management, one-sided pursuit of economies of scale, thus construction management level remains at a relatively low level, and capital management is relatively falling behind. All these aspect have becoming the bottleneck to constraint improving competitiveness and efficiency of Construction enterprise. Construction industry itself has a decentralized feature, and as more and more domestic companies have joined the ranks of international competition, this character has becoming more and more significant. Across multiple markets, switching to different Engineering field in a short time; undergoing production activities far from headquarters; needing a lot of construction machinery; adequate liquidity; the necessary monetary funds, which all determines its financial management should have huge indifference from other industry. More attention should be paid in cash flow management.

### **3 CONSTRUCTION ENTERPRISE CASH FLOW MANAGEMENT OBJECTIVES**

Because of construction enterprises falls under great influence due to market factors, the funding capacity and ability to resist risk is relatively weak, while heavy manufacturing, light management, its accounting capacity is weak, as well as the lack of internal control, focus on short-term interests, and lacking of cash flow management. The existence of these issues of construction enterprises require us to address through the financial management and strengthening cash flow management. For the construction business, the basic objective for cash

flow management is to ensure the funds needed for general production and operation activity, while enhancing cash flow and improves operational efficiency, which eventually allows companies to grow in the steady strength and expand based on stable development. Construction enterprise cash flow management objectives are as follows:

#### **3.1 Actively Raise Cash Flow for Business Operation**

Due to the fact that construction enterprises exists some of its own particularity, the demand for capital are centralized and in stabilize, also has shortage of monetary funds and narrow channels financing fund. The main source of financing is internal financing which leads to equity fund becomes a very important source of liquidity. So for the construction enterprises, they should gradually increase the absorption of credit funds by improving operation management, standardizing financial system, improving core competitiveness and sustainable development capacity. They should also adhere to honesty and trustworthiness, improve creditworthiness, won the trust and support of banks and as well broaden the financing channels. When raise funds, attentions should be paid on ratio of enterprises own funds and debt capital. It is necessary to make active use of external funds, and the use of financial leverage, but also fit with enterprise's own scale, reduce business risk, and minimize the cost of funds to the lowest.

##### **3.1.1 Strengthen Operating Management of Cash Flow, Improving Efficiency of Funds**

The investment of construction companies should be medium to long term investment projects. The investment should focus on core competencies construction projects, reinforcing the foundation, and avoiding blind diversification. The company should learn from the experience from some large enterprises in the development process, identify their goals, and make rational use of cash flow, so that they could go through steady development and strengthening cash flow management. Only when companies know their own stage of development, and position the direction of a its business development, make rational use of resources, while strengthening cash, accounts receivable and other construction costs can they gradually increase the efficient use of funds.

### 3.1.2 Enterprise Value Creation

The objective of financial management is to maximize corporation value, which reflects the business goals from the perspective of business owners. Profitability of enterprises is a basic goal in the target system, but the business goal is not to "maximize profits", but to maximize long-term capital appreciation. Financial management is to manage the availability and effective use of related funds, strengthen the management of funds, improve profitability, control costs, accelerate capital turnover, and avoid business risk and financial risk, in order to achieve maximum enterprise value.

## 4 CONSTRUCTION ENTERPRISE CASH FLOW MANAGEMENT MEASURES

### 4.1 Cash Flow Basic Management

First process is to make clear bank account journal and cash journal statement, make sure to better management the reconciliation between businesses and bank. A company should also strengthen the sense of credit, improve credit rating, be honest and trustworthy, standardize operation, and actively expand financing channels. Strengthen cooperation with banks and other financial liaison and collaboration, make the use of commercial credit in the form of financing, but also pay attention to non-merchandise transactions in the use of credit method. Make flexible use of funds to improve capital efficiency, to keep abreast of corporate cash flow, inventory, project costs, accounts receivable etc. Make scientific arrangement of funding, effectively use of capital, lower capital costs and improve efficiency in the use of basic cash flow management

### 4.2 Establish Cash Budget and Strengthen Financial Management

Construction enterprise needs to establish and improve budget preparation, approval, monitoring, assessment of the overall budget control system. Budget range from single operating revenue and expenditure plans should expand to the production and management, infrastructure, investments and other comprehensive capital budget. According to

the characteristics of construction enterprises, the implementation of financial budget management should follow the following procedure: First, the bottom-up step by step plan when establish budget funds; second, top-down; approve the budget through some form of meeting. Corporate functions should determine the budget of next month by collecting and confirming the budget plan of the subordinate units, change the current "count after use "situation to "count before use "situation; Third, the implementation of strict budget adjustment process. In principle, the budget can not to be altered once approved at all levels, and for special reasons, it should follow the strict adjusted system; Fourth, establish strict monitoring and evaluation system. The essence of financial management is the supervision and control of cash flow all from all aspects, that is, to apply budget management and fixed assessment as well as the implementation of dynamic monitoring, quantitative level of expenditure on production of construction, tasks contract, purchase of equipment and infrastructure investment process.

### 4.3 Strengthen Fund Procure Management of Construction Enterprises

Raising funds is a behavior of enterprise through funding channels and capital markets, and the use of financing to obtain the necessary funds in accordance of the needs of its production operation investment and structural adjustment.

#### 4.3.1 Meet the Needs of Construction Production and Investment

Any modernized construction enterprise can not rely on capital from investors to engage in construction, production management; it has to rely on other channels such as bank or society to raise the necessary funds. Because the construction business not only needs a big amount of fund but the occupation of funds take a long time. With the constant expansion of the construction, company needs to keep making investment on mechanical equipment and components which increasing the demand for capital. At the same time, in order to reduce construction costs, such as the of building related companies seeking related business, such as construction materials production company, to coordinate with construction also need to raise funds for other enterprises in investment holding, to

participate in its production and management decisions.

#### **4.3.2 Meet the Needs of Capital Structure Adjustment**

The adjustment of capital structure is the adjustment that enterprises made in order to reduce the cost of capital, while avoiding the risk of capital financing by adjust relationship between debt financing and capital. Adjustment of capital structure decisions are matters of major financial decision as well as the content of corporate finance management. There are many ways to adjust the capital structure, such as to increase the proportion of the capital by increasing business capital, to improve profitability and reduce the capital cost of funds by increasing debt capital, to make debt maturity structure more reasonable by combining short-term debt with long-term one, etc. All these activities belong to the fund-raising acts of optimize capital structure.

#### **4.4 Strengthen Management of Cash Withdrawn During from Project Settlement Phase**

Getting the payback of project funds needs implement the project leader responsibility system. Closely linked the recovery of funds and the project leader's performance appraisal, and then apply of vote veto system. Whenever the project payment is not fully recovered, honors of all kinds shell not to be awards. Construction companies have their own particularity; a variety of changes would be encountered by various environmental, geographic conditions affect. To ensure a smooth recovery fund of projects, the company should take all evidence information to prevent the arrears besides contract part. During the construction period, the company must apply for allocation of projects fund in time. Construction enterprise should set up a special group on clearing debts; active seeking recovery for projects, and if under special circumstances, legal measures should be taken to protect business interests.

#### **4.5 Establish Evaluation System on Cash Flow**

In certain period of time, management of cash flow can at least make sure the repayment of maturing debt and is timely. In the longer term cash flow management within the enterprise should be able to achieve the goal of adequacy and effectiveness.

More specifically, financial analysis index, such liquidity indicators, profitability indicators, indicators of financial flexibility and benefits of quality, could be use to indicate whether the cash flow is normal.

## **5 CONCLUSIONS**

Cash flow management of construction enterprise has becoming the most important factor of financial management. Construction enterprises should pay attention and to enhance corporate cash flow management of all aspect, develop appropriate cash flow management programs to ensure the cash flow can be well balanced, and provide effectively protect to healthy development of construction enterprises.