Following on from these themes and the views expressed by the senior executives we interviewed this year, the next few articles discuss working capital from an insolvency and consultancy perspective, as well as cost reduction and employee expenses, and the various PPP/PFI opportunities across Europe.

Survival of the fittest – The view of an insolvency practitioner

It is worth keeping a close eye on what construction design teams are doing, because they are invariably the barometer of the sectors health. It will not have escaped anyone's attention that, as a result of declining workloads, many of the leading architects, engineers and quantity surveyors have taken significant steps to reduce costs. Of particular note is the fact that contractors have been alerted to the need to 'right size' their organisations.

Another indicator of the sectors health is the credit insurance market, and this is one area that has surprised with the speed at which it has hardened. If trade credit insurance is withdrawn or reduced, suppliers will seek to improve their credit terms and demand shorter payment times (or even cash on delivery), which will in turn have a direct and potentially catastrophic effect on contractors' cashflows. It will not be lost on those close to the sector, that an increasing number of insurers are withdrawing cover due to the instability of the market. For example, it has been widely reported that the fifth largest credit insurer, Amlin, announced it would withdraw from the credit insurance market in 2009. Other insurers, including Euler Hermes, Atradius and AIG, are all reportedly robustly reviewing their portfolios. The resulting impact on the sector could be huge. This is a real threat, as evidenced by Aon, which recently confirmed that trade credit insurance for house-builders had fallen by between 50% and 100%. In addition, tightening restrictions on contractors' performance bonds will have a significant impact on construction companies when they seek to renew their current arrangements.

Avoiding a cashflow crisis

So, what should construction companies be doing to ensure that they do not become another casualty of the current economic and market turmoil? Experience has taught us that there are two main areas a construction company must focus on in a declining market. Most important of all is an unwavering concentration on cash and working capital, and second is the need for strong corporate governance and risk management.

A number of high-profile failures, caused in part by poor cash management, are forcing companies to reconsider how they manage this aspect of their business. How sure are you that you will not be next? And how could you avoid a cashflow crisis?

Some areas worthy of focus include:

- Establishing clear and unambiguous rules with regard to the management of variations and claims.

- Ensuring that the natural tension in terms of cashflow between the design, construction and facilities management phases is understood and taken into account.

- Understanding the limits of partnerships and so-called 'special' relationships. The 'get things done' attitude should always be complemented by agreeing revised costings, when appropriate. It is amazing how special relationships at the beginning of a project are often not so special by the end of it.

- When variation orders are required, ensuring that supporting documentation and sign-offs are all in place.

- Not being afraid to pursue claims and seek adjudication, even if they are disputed in the first instance.

- Not forgetting to manage back-to-back contracts, whether you are a subcontractor or a main contractor, as they can wreak havoc with your cashflow.

- Producing regular and robust ‘cost to complete’ estimates.

- Keeping on good terms with your bank manager.

Focus on corporate governance
It is noticeable that a growing awareness of corporate governance has seen a marked shift by businesses and perhaps more importantly their banks, lenders and shareholders, to seek increased transparency and understanding of site-based operations on construction projects. Cost and value reporting together with good cash management has always been the bread and butter of any successful contracting organisation, but businesses are now reinforcing their processes to ensure a more comprehensive and transparent understanding of their projects and wider business performance.

Such issues are not just restricted to the sector’s ‘Premier League’, robust processes and controls supported by regular reviews are just as crucial to small and medium-sized companies.

So, how might you avoid some of the issues that have impacted others in the sector, while at the same time providing increased comfort to your stakeholders that everything is in good shape? Some actions that you might consider include:

- Undertaking regular and detailed bottom-up reviews of business operations, from site activities through to management reporting.

- Where appropriate, considering implementing a robust internal audit function.

- Providing clearly-defined commercial policies and procedures on what (and when) contract values should be recognised.

- Considering the application of standardised reporting tools and techniques, especially across different divisions and/or geographies.

Looking ahead
While in the recent past the construction industry has focused on growth and profit, cash and working capital management will be at the heart of every firm’s survival.

Some companies are adapting to this faster and more effectively than others, and those that adapt quickest are most likely to preserve the profit and loss statement, as well as the balance sheet. Those companies that chose to ignore the signals and do not adapt quickly could well be heading for some very difficult discussions with their lenders.