

Contractor Tips & Advice: Financial Management



The Construction Industry Development Board



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Analysis of trends in the Register of Contractors indicates the need to assist and guide contractors on business management. This will further complement their existing technical capability for them to realise their full business potential. A significant percentage of contractors have the potential to grow from their current **cidb** grade to the next or higher grades. The most common shortcoming is the contractor's financial capability; a combination of turnover and employable capital. Contractor growth is particularly hampered by:

- Poor inventory and cash flow management
- Over-investment in fixed assets
- Poor credit arrangements
- Personal use of business funds
- Attempts to minimise Tax or VAT figures by reflecting incorrect financial figures
- Reluctance to use professional accounting officers or auditors in compiling annual financial statements

The following general good practices and tips for contractors are recommended to assist contractors to improve and sustain their grading (This, however, by no means guarantees access to finance nor increased **cidb** grading, but enhances the possibility for these):

- **Understanding basic principles and laws that govern a business:**

Many of today's successful construction business owners began as employees of other firms. If you are considering leaving employment to become a contractor, you should ensure that you become exposed to the principles of operating your own business. There are a number of courses and books on starting up your own business, but some specific laws and regulations may also apply to your specific field, for example registration with professional councils or bodies like the Department of Trade and Industry (dti), **cidb**, NHBRC, SACPCMP, and so on. It is also important to ensure compliance with tax requirements such as VAT, pay as you earn (PAYE) and other levies required by the South African Revenue Service (SARS).

- **Maintain strict separation between business finance and personal finances:**

A good starting point to successful management of finances is to separate your business from personal finances. Open separate bank accounts for business and personal finances. It is advisable to open a cheque account for business purposes. All the major banks in South Africa have dedicated banking services for Small and Medium Businesses (SMMEs) and will assist you to open a business account with affordable capital outlay.

A common mistake by contractors who do not separate business from personal finances, is the tendency to use money received for business to cater for personal luxuries, such as a luxury vehicle to 'profile' their 'perceived' success. Such practices are harmful to their long term business growth.

- **Financial management systems:**

Be organised and keep proper financial records including record of income (money in) and expenses (money out) and other financial business transactions. Every business needs to record all financial information. This system will help you to assess properly how the business is performing financially. It answers questions like "how much profit or loss did the business make this month?" or "how much money should be in the bank to ensure unhindered and smooth operations?". Such services and information can be captured by a book keeper and annually verified and compiled into the correct format by an Accounting Officer or

Auditor, based on your company registration legal requirements. The abovementioned information is a critical requirement for the cidb to categorise contractors within the accurate and precise grade.

- **Reinvesting money into the business:**

It is important to put a certain portion of profits that your business makes back into the business in order to help the business grow. For example, some profits may be used to buy or deposit an asset such as a van or truck or equipment that the business needs in order to be strong and to grow. It is advisable to utilise profit generated from the previous project for the next project. This will enable you to provide your own capital for your next project while simultaneously helping you to grow your business. This eliminates costly interest-bearing 'project start up' capital, and performance guarantees that are normally required prior to being able to continue with an awarded tender. Investing in your business also requires that you invest in your employees, in areas like training and empowerment.

- **Avoid cession of payments:**

Many emerging contractors depend on suppliers of materials to start and complete their construction projects. To obtain these materials, they cede or surrender portions of their tenders/contracts to the materials suppliers. The basis of this arrangement is that the money that the contractor makes from the project is deposited directly into the bank account of the materials supplier and the emerging contractor gets the remaining balance after deductions have been made.

This practice presents a problem in that the project finances are deposited into the bank account of the material supplier and not of the contractor, hindering the development of the contractor's financial track record. The result is that there will be no reference of the project's turnover in the contractor's banking statements. As a result, the contractor loses out on future opportunities because they cannot prove a 'good' banking history.

Developing Contractors are advised to directly approach finance organisations that offer appropriate customised business solutions for various situations. This assists developing contractors with mechanisms and support systems. This support should ensure good cash flow and sustainability of projects through tailored finance packages. These interest rates, administrative costs and fees must be negotiated to ensure that the fees are equated against the actual value-added services rendered. Formal banks also structure packages with support services, or employ support service companies to provide finance and support to contractors.



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- **Avoid split banking:**

Building a history with one banking institution will enable you to build a strong relationship with a single bank and can lead to a good credit record and act as a source for future referrals. However, should your bank not be offering you the most financially viable or competitive product in the market, feel free to re-negotiate your rates or move your business to a better option.

- **Present a true financial position of the enterprise:**

Contractors are advised, at all times, to show a true financial position and performance of their enterprises on their financial statements, for the benefit and growth of the business. The [cidb](#) discourages contractors from the practice of developing different sets of financial statements for different purposes, such as presenting one set of low financial figures for tax purposes (SARS) and another of high figures for banks or when applying for loans or for improving grading status at the [cidb](#). This is detrimental to their business. Submitting reduced turnovers to SARS is illegal, and you will be 'doing yourself a disavour' in that the longer term sustainability of your business will be compromised. Shared information databases between regulatory authorities enables identification of illegal business activities, which will result in severe action against identified fraudsters.

- **Keep records of all business transactions:**

Keeping regular and good records of all business transactions speeds up the preparation of annual financial statements. It is recommended that financial statements are compiled by a registered accounting professional - an Accounting Officer or Auditor. These records can also be used for interim information that may be requested by banks, which will fast track assessments and show your professionalism.

- **Keep track of your liquidity ratio:**

Aim for a favourable liquidity ratio - this means that current liabilities are not to exceed the current assets, so that there is always enough cash-flow in the business to finance projects, emergencies or contingencies.

- **Insurance:**

Always ensure that in the event of any unforeseen circumstances like death, security infringement of your account or theft of your cheque book or credit/debit card, that you are adequately insured. Banks offer minimal premiums for such insurance covers.

- **Use of Professionals:**

Never underestimate the value of using professional expertise such as accountants, legal advisors or insurance and investment brokers who will advise on issues related to the stock market, wills, trusts, and so on. A small investment in such professional advice may, in the long term, save you financial pains.

Facilitating access to finance for contractors:

The cidb has engaged a number of potential financiers in its endeavour to assist and ease contractors' access to finance. Partnerships have been forged with some of the institutions for both performance guarantees and working capital. The onus is however on you to negotiate and ensure the best offerings are made available to you.



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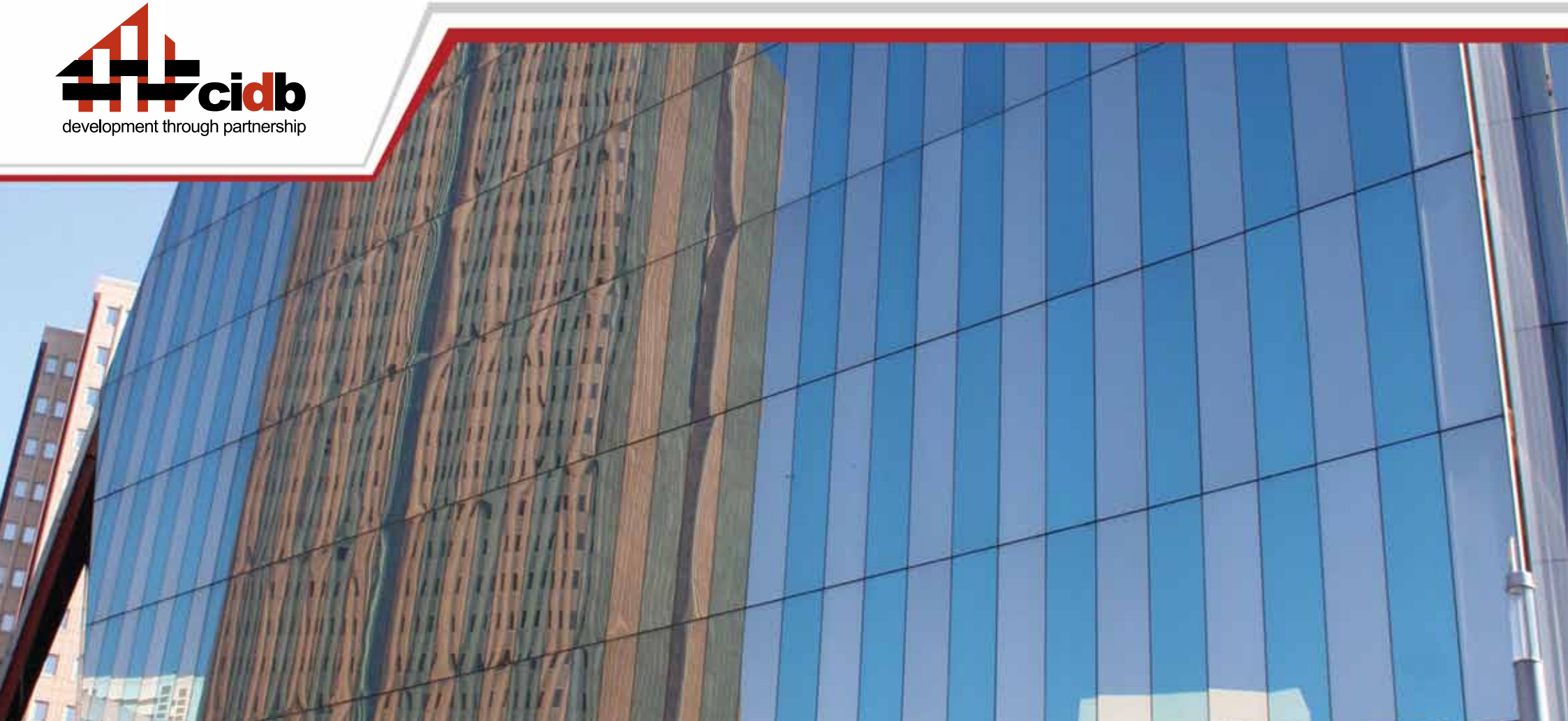
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