***Project Business Management*[1,2]**

Cashflow Matters in Project Business

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"Never take your eyes off the cash flow because it's the lifeblood of business.",
Richard Branson

Summary

This article explores two case stories that underscore the importance of aligning financial practices with the requirements of Project Business: Nexus Innovations grappled with financial discrepancies from early payments, whereas Harris Structures faced cash flow issues due to late payments. Both cases emphasize the need for transparent communication and robust financial controls to maintain project success and financial stability of contractors in Project Business.

[1] This is an article in a series by Oliver Lehmann, author of the book "Project Business Management" (ISBN 9781138197503), published by Auerbach / Taylor & Francis. See full author profile at the end of this article. A list of the other articles in PM World Journal can be found at https://pmworldlibrary.net/authors/oliver-f-lehmann.
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What is Project Business?[3]

Project Business takes place when two or more organizations do a project together as customers and contractors. In Project Business, the project is no longer solely there to support a business. It is the business.

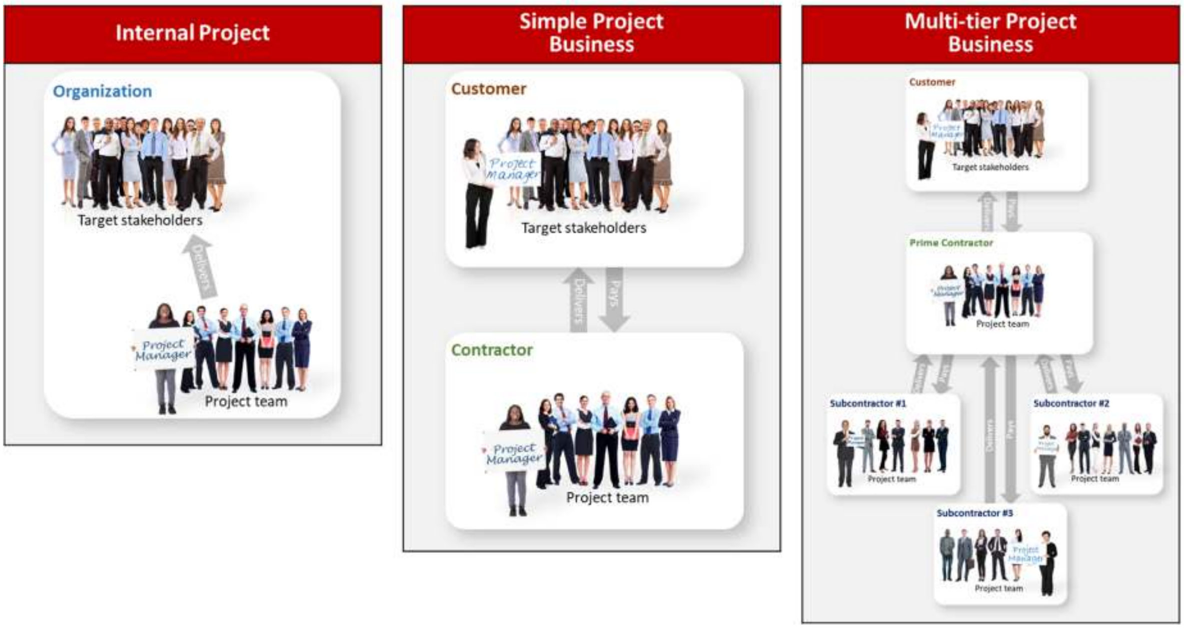

Figure 1: In contrast to internal projects, where the target stakeholders of the project and its performing team are located in the same organization, Project Business is cross-corporate with two or more—often many more—organizations involved.

Project Business is different from internal, cross-functional projects. In a simple scenario, there may be just two organizations involved: A customer and a contractor. In mega-projects, such as big infrastructure, aerospace and defense programs, or even Olympic games, there may be hundreds of organizations working together towards a common goal. Typically, these organizations build complex and dynamic multi-tier project supply networks, and for most of them, the project is not a cost center; it is a customer project—a profit center. It must bring money home and safeguard the organization's credit line.

Many companies rely on project business as their sole source of income. As contractors, they sell project services and products against payment. Others include customer projects as a component in their proposition packages: They sell hardware, software, or ongoing services, and the project to implement these on the customer side is part of their success formula for the paying customer.

The high art of Project Business is forging the different organizations together and making them follow a common mission: The successful completion of the project. Ideally, contract

[3] This section is a repetition from previous series articles.

parties become project partners teaming up for the benefit of each of them and for the smile on everyone's face when they have achieved a desired and distinguished result together, a result that one organization alone could not have achieved.

In real life, this art is rarely found. Project Business is too often burdened with incompatible business interests, poor communications, quarreling, and finger-pointing:

- Customers find it hard to ensure they receive the services and deliveries they ordered and for which they are prepared to pay.

- Contractors struggle to reconcile their three main objectives: Happy customers, appealing margins, and a sustainable cash flow for the organization. Often, making the customer happy requires extensive outlays in the form of work and money, and it is indeed not rare that a contractor can no longer afford these outlays and slips into illiquidity even in an otherwise profitable customer project.

When one asks project managers what they perceive as a trend, more internal projects or project business, an overwhelming majority respond that it's Project Business.

Project Business is not a fringe topic of project management—it's a big, global trend across all industries.[4]

The following case stories will address two common issues of cash flow management for Project Contractors: Early and late payments.

When Payments Precede Deliveries – a Case Story

As a contractor, timely payments are crucial to maintaining a steady cash flow. However, it can be equally problematic if payments are received too early, as the following example shows:

In the bustling city of Newborough, Derek Mullins[5], the ambitious founder of Nexus Innovations, a software development firm, was facing a peculiar predicament that threatened to rattle the very foundations of his company. Nexus Innovations had recently delivered a state-of-the-art software system designed to streamline operations for Prestigium, Inc., a major marketer of luxury goods. The project was a technical marvel, promising to revolutionize how Prestigium managed the relationships with its buyers on a global scale.

[4] (Project Business Foundation, 2021)

[5] All names are changed.

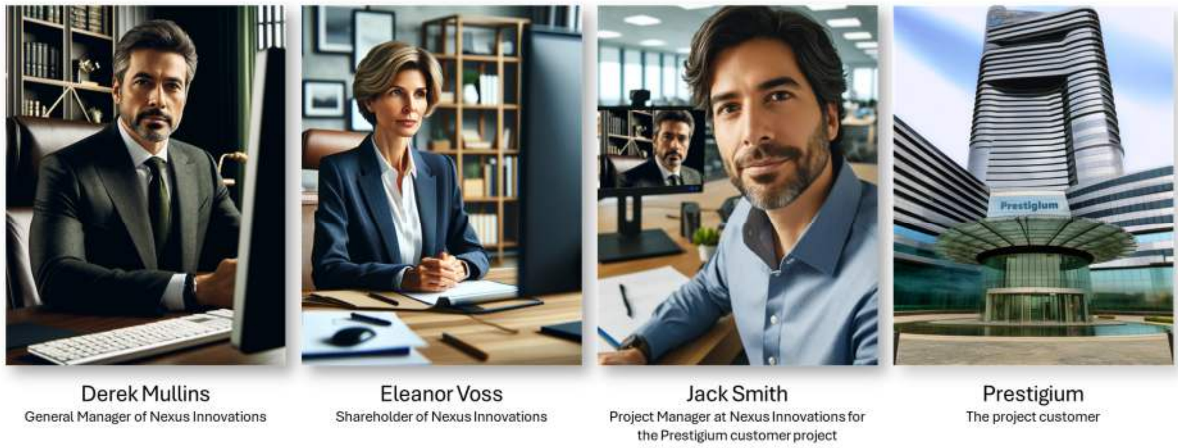

Figure 2: The stakeholders involved in the case story

The trouble began when Derek, eager to impress and expand, pushed to complete the project within the last quarter of the 2023 business year. His team, led by the project manager Jack Smith, worked tirelessly, burning the midnight oil to meet this deadline. Indeed, by the end of the year, the software could be handed over and Prestigium, Inc., pleased with the progress and eager to start the new year afresh with the new system, paid the final settlement for the project still in December 2022, a financial win Derek celebrated.

However, the real completion of the project took longer. It included:

- Fixing complaints that turned up during the first weeks of operations,
- Removing breakdowns of connectivity to legacy systems
- Critical implementation testing

This work spilled over into the first months of the next year. This meant that while the revenue from the project was recognized in the previous fiscal year, expenses continued to accrue well into the year of 2024.

This accounting discrepancy went unnoticed until the quarterly financial report to Nexus's shareholders in early April 2024.

At a virtual shareholder conference, Derek presented the financial results for 2023, showcasing a robust profit margin and significant revenue from the Prestigium project. The shareholders, initially impressed, quickly turned skeptical when the financial statements for the first quarter of the new year revealed unusually high operational costs with no revenue to cover them.

"Mr. Mullins, could you elucidate why our expenses have soared this quarter without corresponding revenue?" asked Ms. Eleanor Voss, a sharp-eyed and influential shareholder with a knack for details.

Derek, caught off-guard, stammered through his explanation, revealing that while the payment for the Prestigium project was secured the previous year, the associated costs bled into the current year. This mismatch had inadvertently inflated the previous year's profit figures while burdening the current year with unforeseen expenses.

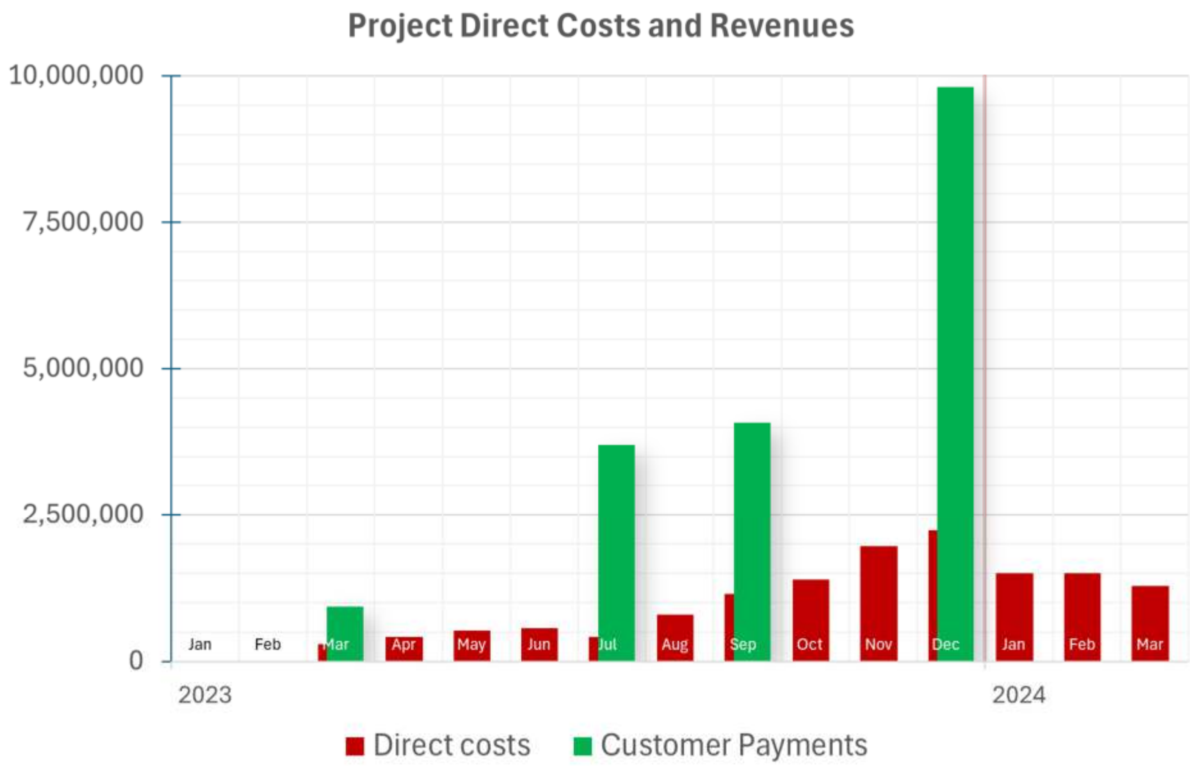

Figure 3: The direct costs and the revenues from Nexus Innovations's project for Prestigium Inc.

The meeting buzzed with unrest as shareholders chatted among themselves privately, discontented with the oversight. Ms. Voss, taking the lead, expressed her concerns, "This oversight not only distorts our financial health but also raises concerns about our management's foresight and transparency. How can we trust future forecasts if past achievements are shadowed by such discrepancies?"

Derek asked Jack Smith, the project manager in charge of the Prestigium project, to join the meeting ad-hoc and provide further details on the project. Jack emphasized his commitment to the satisfaction of Prestigium, stating that his concern as a project manager was not profitability or cash-flow. He further stated that due to the project's delay, his primary objective was to complete the work to the customer's satisfaction, and he had no available time to expound on the project's commercials to the finance department.

Jack further explained that the customer made the payment still during 2023 to use existing budget and gain full tax benefits from the investment. The work done in 2024 was mostly to do more testing, fix errors and inconsistencies, and improve the connectivity to the customers' legacy systems. Jack said he assumed that according to the contract with the customer, this was the contractor's job, and as the customer had already paid for it, it had to be done.

More questions were brought up by Eleanor and the other stakeholders. They complained about Jack's indifference to the project's commercials as they finally created the assets at Nexus that paid his income. They further noticed that the project's seemingly high profitability by the end of 2023 entitled Derek Mullins to a major bonus payment that he would not deserve where the timing of project work and customer payments aligned:

Numbers per 12-2023		
Project revenue (= cumulated payments received from the customer)	$	18,500,000
- Project direct costs	$	9,741,661
Margin from the project	$	8,758,339
Numbers per 03-2024		
Project revenue	$	0
- Project direct costs	$	-4,282,332
Margin from the project	$	-4,282,332
Total		
Margin from the project	$	4,476,007

Derek realized the gravity of the situation: His handling of the situation had jeopardized the trust of his shareholders due to the timing mismatch of revenue and expenses, but also due to the neglect of the project's financials by the project manager, poor communications, and a bonus payment to him that seemed unmerited. He needed to regain their confidence and quickly proposed a plan:

"I understand your concerns, and I take full responsibility for this oversight. Moving forward, we will implement stricter financial controls and ensure that revenue recognition aligns with the actual completion of our projects, or, when this is not possible, communicate and explain the divergence. Additionally, I propose internal quarterly financial reviews to maintain transparency with all stakeholders. And of course, the year-end bonus for 2023 will reflect the costs that occurred after the last payment by the customer."

The shareholders, though still cautious, appreciated Derek's quick commitment to transparency and governance. They agreed to the proposed changes, emphasizing the need for consistent updates and strict adherence to the new financial oversight measures.

Thus, Nexus Innovations navigated through this fiscal turbulence, learning a crucial lesson in financial management and shareholder communication.

When Payments Come Late

In the sprawling urban landscape, where towering cranes and steel skeletons marked progress, Jacob Harris guided his company, Harris Structures, with cautious optimism and sharp acumen. His construction firm, over the past decade, had grown from modest beginnings to taking on ambitious projects such as high-rise office spaces and expansive retail complexes. The contract to build several new outlets for MegaCorp, a retail giant, appeared as a golden opportunity to cement Harris Structures' reputation in the construction industry.

The project started on a high note in January 2022, with early deadlines being met and teams mobilized with efficiency under the watchful eye of Anne Myers, a project manager at Harris Structures. Anne's experience and dedication had always been a cornerstone of the firm's success, but the current project tested her resolve in new ways.

Figure 4: The people involved in the case story and their project

On the other side, the dynamic was complicated by a procurement manager named Liam Rush, employed by MegaCorp. Liam was meticulous and often stringent in his expectations.

As the project progressed through 2022 into 2023, a significant issue began to emerge in the form of payment delays. These delays were not due to the typical logistical hurdles that one might expect, but rather from internal communication snags within Anne's team. The members of her team found themselves too occupied with technical project tasks to report the milestones achieved to Harris's finance department, which was responsible for triggering timely invoicing.

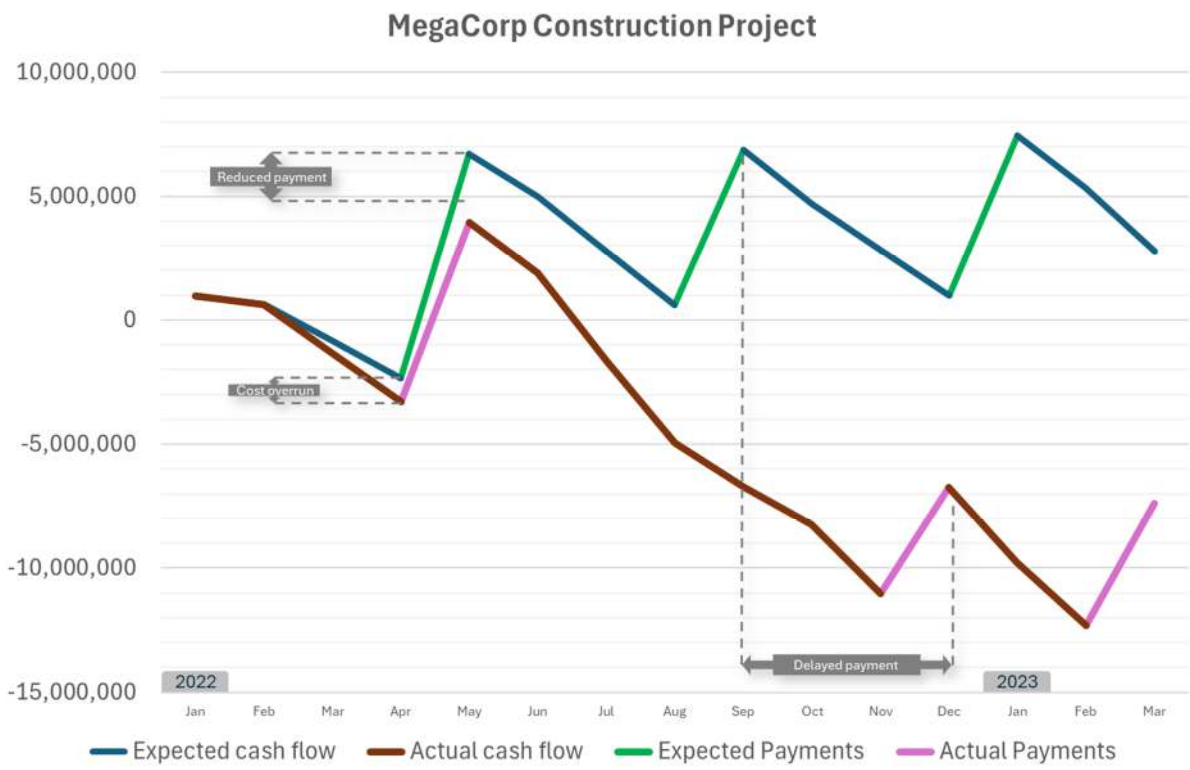

Figure 5: Cash-Flow of the customer project for MegaCorp

The problem was exacerbated by the fact that there was no clear system in place for tracking the progress of the project and reporting it internally. As a result, it was difficult for the finance department to know when to invoice for completed work. This led to delays in payments, which in turn caused frustration and tension between the two teams.

Another cause of late payments was the customer's dissatisfaction with the pace and quality of work being done. This dissatisfaction led to MegaCorp withholding payments, citing the clauses in the contract that penalized underperformance. In addition, the customer reduced payments with the same explanation.

As a third cause, cost overruns occurred from time to time that needed to be paid by the contractor.

Cash flow issues soon followed for Harris Structures, driven by these withheld and reduced payments and the cost overruns. The lifeblood of any project business in construction and anywhere else, particularly one in the midst of expansive projects, is its cash flow. Without it, project work will grind to a halt, and Jacob found his company teetering on the edge of insolvency.

Indeed, the project was expected to have most of the time a positive cash-flow but now began to challenge Harris' credit line. The alarm bells rang particularly loud, when the cash flow exceeded the mark of -$10 million in November 2022 and again in February 2023. Something needed to be done to protect Harris from insolvency.

Faced with this challenge, Anne stepped up to rally the troops within Harris Structures. Recognizing that their survival depended on turning the project around, she fostered a series of strategic collaborations within her team to tighten project oversight and streamline project management. She made everyone aware that the project was a profit center for Harris Structures, and that the company would soon no longer be able to cover the gap in funding, if not all team members took care of costs and reporting of finished work for invoicing. Her strongest argument in these meetings was that the team members' jobs were at stake.

Meanwhile, Jacob sought to bridge the growing gap between his company and MegaCorp. He proposed regular meetings with Liam, attempting to address the concerns head-on and adjust the project delivery to meet Liam's standards.

As Anne drove improvements on the ground, Jacob worked on smoothing relations with MegaCorp, leveraging every meeting to renegotiate payment terms and detail the corrective actions being implemented. His persistence paid off; as the quality of work visibly improved, and deadlines were met with renewed rigor, Liam's reports to MegaCorp's executives became more favorable.

The withheld payments began to flow again, slowly stabilizing Harris Structures' financial health. The project, once a source of stress and potential ruin, became a testament to the company's ability to adapt and collaborate under pressure. By the time the project neared completion, not only had Harris Structures dodged a financial disaster, but it had also strengthened its processes and team cohesion.

At the grand opening of the new MegaCorp outlets, Jacob and Anne stood together, their efforts recognized not just in the gleaming new structures that adorned the city's retail districts, but in the adversities they had overcome. The project had morphed from a near-disastrous venture into a showcase of resilience, strategic thinking, and the power of constructive partnership between contractor and client.

Lessons Learned from the Case Studies

The case studies provided offer valuable lessons in project management, financial oversight, and stakeholder communication across different scenarios in the business world. Here are the key takeaways from each case:

When Payments Precede Deliveries

1. Financial Oversight and Timing:
The premature receipt of payment from Prestigium Inc. led Nexus Innovations to report higher profits for a fiscal year while the corresponding expenses rolled over into the next year. This mismatch caused financial discrepancies that were not initially apparent, demonstrating the importance of aligning revenue recognition with actual project completion to provide a true picture of the company's financial health.

2. Transparency with Stakeholders:
The incident underlined the necessity for transparency and regular communication with shareholders and other stakeholders about financial practices and the true state of affairs. When discrepancies arose, stakeholders felt misled, highlighting how trust is crucial in corporate governance and must be nurtured with clear and honest communication.

3. Management Responsibilities:
The project manager's lack of attention to the financial aspects of the project, focusing solely on technical delivery, contributed to the oversight. This case illustrates the need for project managers to have a balanced focus on both project delivery and its financial and commercial impacts.

4. Proactive Measures and Governance:
As a result of this crisis, Nexus Innovations decided to implement stricter financial controls, such as internal quarterly reviews, to prevent similar issues. This proactive approach aims to enhance governance and ensure continuous alignment of financial reporting with the company's operational realities.

When Payments Come Late

1. Effective Communication and Reporting Systems:
Harris Structures faced payment delays due to insufficient internal reporting and tracking of project progress, which hampered the finance department's ability to issue invoices timely. This underscores the necessity for robust internal communication systems that synchronize project management and financial reporting to ensure that all milestones and completed works are promptly and accurately invoiced.

2. Managing Client Expectations and Contractual Compliance:
The case also highlights the challenges of managing client expectations and contractual obligations. MegaCorp's dissatisfaction with the pace and quality of work

resulted in withheld payments, stressing the importance of maintaining high standards of delivery to meet contractual criteria and client expectations.

3. Financial Resilience and Risk Management:
The severe cash flow issues experienced by Harris Structures due to the payment delays illustrate the critical need for financial resilience in project management. Companies must ensure they have sufficient buffers and risk management strategies to handle payment delays without jeopardizing operational capacity.

4. Leadership and Team Mobilization:
The proactive leadership shown by Anne Myers and Jacob Harris in addressing the issues head-on by enhancing project oversight and engaging more deeply with MegaCorp was crucial. It helped to realign project goals with client expectations, improving project delivery and eventually stabilizing the company's financial health.

Both cases provide essential insights into the complexities of project management and financial administration in large-scale projects, emphasizing the need for meticulous financial tracking, stakeholder communication, and adaptive leadership to navigate the challenges effectively.

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About the Author

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Oliver F. Lehmann, MSc, ACE, PMP, is a project management educator, author, consultant, and speaker. In addition, he is the owner of the website Project Business Foundation, a non-profit initiative for professionals and organizations involved in cross-corporate project business.

He studied Linguistics, Literature, and History at the University of Stuttgart and Project Management at the University of Liverpool, UK, where he holds a Master of Science Degree (with Merit). Oliver has trained thousands of project managers in Europe, the USA, and Asia in methodological project management, focusing on certification preparation. In addition, he is a visiting lecturer at the Technical University of Munich.

He has been a member and volunteer at PMI, the Project Management Institute, since 1998 and served as the President of the PMI Southern Germany Chapter from 2013 to 2018. Between 2004 and 2006, he contributed to PMI's *PM Network* magazine, for which he provided a monthly editorial on page 1 called "Launch," analyzing troubled projects around the world.

Oliver believes in three driving forces for personal improvement in project management: formal learning, experience, and observations. He resides in Munich, Bavaria, Germany, and can be contacted at oliver@oliverlehmann.com.

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- "Project Business Management" (ISBN 9781138197503), published by Auerbach / Taylor & Francis in 2018.

His previous articles and papers for PM World Journal can be found here:

- https://pmworldlibrary.net/authors/oliver-f-lehmann/