***Retentions and bonds***

This is an area of working capital that usually only applies to longer term contracts. A retention means that part of the price is withheld – often for a year – to give the customer some leverage if all isn’t well with the contract. The amount of the retention is typically anything from 2½% to 10% of the contract value.

**The twofold problem with retentions**

Clearly one problem with a retention is the cashflow problem. Up to 10% of the price is being held back. Imagine the impact on your personal finances if 10% of your salary was withheld every month, and only paid to you in December. It would be a nice Christmas bonus, but you’d struggle for the rest of the year!

But the second problem is that most long term contracts are subject to a tender process, so they don’t make much profit. If you’ve got a 10% retention on a £1m contract you’ve delivered, that’s £100,000 retention. But, as a result of the tendering process having driven the price down, perhaps you’re only making 9% profit. So the retention represents all your profit, and more. Not only are you likely to be cash negative throughout the contract,, you’ll remain cash negative until the retention is paid. Your business may be profitable, but it’s likely that your customers are holding all your profit (and maybe more) as retentions.

So the scale of even a small retention in proportion to the profit on the job is a problem, as well as the cashflow problem.

**Bonds – an alternative**

The customer wants a retention to give them some leverage if there’s a subsequent problem with the contract, so we need to give them that security whilst trying to avoid the cashflow problems of a retention.

Bonds can sometimes provide this alternative. A retention bond is effectively a guarantee that the contractor’s bank will make payment up to the value of the retention. The customer has their leverage, but we are paid the retention. This resolves the cashflow problem that retentions otherwise give us.

**Practical issues to consider regarding bonds**

These include:

* ensure expired bonds are followed up and returned by the customer. The bank will not treat it as expired until it has been physically returned
* make sure you have the appropriate authority before offering a bond to a customer!