

Blame? Look In the Mirror

Late payment to contractors is an industry nightmare that violates contracts and multiplies risk. Worst of all, contractors allow it to happen. Having been paid late for so long, contractors think it's normal. Most feel they have no influence over the payment process. The reason is what I have called for many years an "entitlement" paradox. In a commercial transaction, payment is earned, not bargained for. When contractors assent to not being paid in accordance with the contract, they share the blame by not demanding what they are entitled to.

Slow pay and retainage held too long are long-time problems in the construction industry. Too many people are allowing it to get worse by saying, "We can't do anything about it."

The problem begins with construction billing procedures, which are unique. In them, one-sided contract terms provide designers and owners unreasonable control over the payment process. Most contracts direct that a payment requisition be filled out by the contractor and approved by the designer. If the designer doesn't approve the amount, the designer generally red-pencils the requisition and sends it back to the contractor to be retyped. There is no contract requirement to retype the requisition any more than there is a requirement to walk the site and bargain for the amounts. Retyping implies that contractors are overcharging and reinforces the proposition that the designer, and only the designer, will decide what the contractor will be paid.

The inequity of the payment process that has evolved in many building projects is that contractors

are put into the one-sided position of trying to talk someone into agreeing about how much work has been completed and payment earned. Although the amount of work completed speaks for itself and is easily demonstrated, the designer doesn't have to pay the suppliers, hasn't already paid for labor and isn't under any time constraints to approve payment.

So why do some contractors get involved in these "bargaining" practices? Some say, "It's easier than arguing over payment, because arguing will only cause other problems with the designer." Others say, "I don't want the owner to see a red-penciled requisition, because they will think I was asking for more than I should have." Still others say, "The owner's not going to pay until the designer approves it anyway; so what's the difference?"

The difference is that having to bargain for payment is punitive, and in acquiescing to this practice, a contractor surrenders a financial advantage and inappropriate leverage to the designer and owner. Owners are earning interest on the funds withheld while contractors are paying interest on loans to compensate for late payment. There seems to be an attitude among contractors that fair treatment by designers and owners may be contingent on relinquishing payment decisions to others. As long as a contractor intends to live up to

its end of the contract, including every item in the plans and specifications (which is required anyway), the contractor should have nothing to fear from designers and owners.

Contractors are not powerless in the payment process. Payment is not a backroom discussion, and it is not going to be important to anyone unless we make it important. Nothing is going to change if we are unwilling to let everyone know we are not embarrassed to say, "We expect to be paid in accordance with the contract." We need to make it clear that our efficiency and productivity depend on timely payment of labor, subcontracts and suppliers, and that we have no interest in investing in the project—just building it.

There is a cost to accepting late payments that exceed the interest expense. Cash flow problems have caused some contractors to do work not owed or to discount amounts in order to collect, particularly final payments. The forgiven amounts are ostensibly for work not performed or accepted, but they are usually pure concessions.

I have experienced construction enterprises with so much of their reserves tied up in receivables that they could not pay their bills and were forced into the hands of their creditors. Much of the cause of financial distress is unpaid receivables, and contractors have to shoulder part of the blame for not demanding what is rightfully theirs. The problem can be rectified with a concerted, unified effort. ■

Thomas C. Schleifer, Ph.D., is a recognized turnaround expert who is conducting research into industry payment practices. He welcomes comments and examples of payment problems and solutions and can be reached at tschleifer@q.com.

If you have an idea for a column, please contact Viewpoint Editor Richard Korman at kormanr@enr.com.



SCHLEIFER