ORACLE
Construction and Engineering

# Modern Payment Management

How Optimising Subcontractor Payment Processes Drives Efficiency and Reduces Risk

## INTRODUCTION

Managing the applications, valuations, and payments process in the construction industry has historically been largely manual and paper based. Main contractors and their project teams devote a great deal of time and resources to managing large volumes of payment documents, invoices, compliance documents, variations, and VAT- and CIS-related items.

On top of that, other critical payment materials continue to be generated and exchanged in disjointed, non-collaborative, and inefficient ways.

As a consequence, many main contractors and subcontractors remain mired in an endless paper chase that costs time and money, and needlessly exposes their organisations to risk. This exposure grows when factoring in laws and regulations such as the UK Construction Act.

Failing to adhere to payment timeframes means main contractors can end up facing high-profile, public issues with regulatory bodies.

This whitepaper will examine the impact of traditional payment practices on key stakeholders – main contractors, clients and subcontractors – and show how cloud-based payment management software can help you to transform payment activities and deliver improved business outcomes.

## INEFFICIENCY

Reviewing the traditional payment process in construction highlights built-in inefficiencies.

At the start of each payment period, subcontractors are invited to request payment based on work completed, with pay applications delivered by email or other means. The project commercial and finance teams then have to review the materials for accuracy in terms of payment amounts and what is due. This includes checking for correct retention, VAT, and CIS amounts. Typically, these calculations are performed manually and tracked on spreadsheets, of which there can be multiple non-compliant versions.

If problems are identified, the subcontractor must be contacted via phone or email to resolve them. The resulting back and forth prolongs the process and wastes time. And if subcontractors fail to follow the appropriate channels, applications can simply be lost.

Subsequent steps in the process include multiple additional reviews, each with the potential for further reconciliation and reworking.

This makes it even harder to track against UK Construction Act dates and guidelines.

Having invoice information manually keyed into spreadsheets and financial systems such as enterprise resource planning (ERP) solutions can also lead to incorrect and duplicated data. Which requires even more time to identify and correct.

Manual, paper-based management of compliance and variations involves the same risk of extra effort and delay, as questions and errors are resolved, and missing documents obtained.

Together, these steps significantly lengthen the time needed to prepare and submit client applications, impacting cashflow and working capital for both the main contractor and their subcontractors.

This traditional approach to managing payments in construction entails an opportunity cost too. With commercial and finance staff spending so much time on document processing, follow up and reconciliation, they have less time to devote to tasks that would deliver greater value to their business, such as internal audits and in-depth client application and payment reviews.

## SHIFTING TO VALUE-ADDED TASKS

| Lower ROI Activities | Higher ROI Activities |
|---|---|
| • Performing clerical reviews of invoices<br>• Routing documents<br>• Checking on the status of subcontractor information<br>• Calling subcontractors to resubmit information<br>• Explaining payment holds | • Reviewing percentage complete<br>• Negotiating contracts<br>• Evaluating variations requests<br>• Project cost management<br>• Assisting in planning cash outlays<br>• Reporting on job performance |

In addition, the lack of scalability in traditional payment management limits the ability of main contractors to grow their businesses without a corresponding increase in support staff. Growing headcount naturally incurs significant and unnecessary recruitment and employment costs.

The impact across all the projects in a main contractor's portfolio underscores the significant, enterprise-wide cost of inefficient payment management processes.

### Questions to ask:

- Does my organisation face complications from inaccurate or missing payment or compliance materials?
- Does my team spend a significant amount of time going back and forth with subcontractors on queries?
- Would my organisation benefit from delivering client applications for payment more quickly?
- Do we need to ensure payment management processes are scalable to enable limited-cost business growth?
- Are paperless activities and sustainable practices important to my organisation?

# LACK OF VISIBILITY

Main contractors, their clients, and partners also face challenges due to the lack of visibility in traditional paper-based, manual payment processes.

With disjointed and siloed offline processes responsible for handling and storing the myriad documents required, it's hard for all stakeholders to determine the status of critical, time-sensitive activities.

For example, a commercial manager tasked with reviewing payment applications can't easily determine where a given application is in the accounting process, or if it's been submitted. Even the finance team may be unaware of the status of various applications sent to the commercial manager, prompting further confusion within the project team.

The subcontractor for their part only knows that they've sent an application and it will be paid at an undefined time. If cross-party communication breaks down, the subcontractor may be unaware of a compliance failure from a payment being held until it's too late.

This lack of transparency can lead to mistrust and disputes between project partners. Given the importance of strong relationships between construction managers and contractors, this can be costly, especially when quality contractors may be scarce.

Considering again the number of transactions in a project, and the projects in a portfolio, indicates the true scale of the threat to project delivery.

Payment documents from multiple subcontractors being handled by multiple people from the main contractor can risk generating multiple versions of the truth. In some cases, a subcontractor may have submitted an application to more than one person from the main contractor. And there may be no way to spot and remedy that problem until it has progressed to a damaging point. When that happens, it can be difficult to piece together an audit trail and trace the problem to the source.

For a project owner, this limits their ability to determine how effectively payments and compliance are managed, where problem areas exist, whether project subcontractors are paid once funding has been provided, and if they've been paid on time.

**Questions to ask:**

- Do team members lack the visibility into payment activity statuses they need to do their jobs efficiently and effectively?
- Do team members spend a significant amount of time answering payment status questions from subcontractors?
- Does my organisation lack visibility into how payments affect financial data across the business?
- Would we benefit from better relationships with subcontractors?
- If my organisation were to have a problem, such as an incorrect payment being made, would it be difficult to identify the cause?
- Could lack of visibility lead to bad press for my organisation?

# RISK

Traditional payment management in construction exposes main contractors and clients to risks. Ones that threaten the bottom line and the core goal of any construction project: clean handover of the project, completed on time, and in budget. Given the paper-thin margins many main contractors face, these risks can't be ignored.

Payment management activities encompass four key areas of risk. Each is potentially damaging and can expose owners to reputational and financial problems.

**1. Improper payment, either from fraud or errors**
**2. Compliance-related risk**
**3. Failure to comply with UK legislation**
**4. Subcontractor default**

## 1. Improper payment

Improper payments result from a lack of adequate controls in payment processes. In traditional processes, main contractors may lack the visibility and safeguards required to prevent fraudulent payments, such as those tied to unapproved variations. Disjointed management processes across the main contractor's operation may prevent the visibility and approval workflows needed to ensure such payments are prevented.

Improper payments can also be made when clerical errors are not caught. An inability to easily review invoiced amounts against a project's schedule of values (SOV) adds to this issue. Finally, improper payments may result from failing to detect a deficiency in a subcontractor's compliance documents in time.

## 2. Compliance-related risk

Compliance risks happen when subcontractors fail to maintain the complete and current insurance and compliance documents required to perform and be paid for work on a construction project. Ensuring that all subcontractors, material suppliers, and other stakeholders involved with a project are insured and have provided up-to-date compliance materials takes time and effort. Without proper ongoing validation of these documents, main contractors risk non-compliant payment of subcontractors.

## 3. Failure to comply with UK legislation

It's one thing tracking the actions and progress of a construction project. It's another matter ensuring that all departments who touch the payment process throughout are doing so in a compliant manner.

The UK Construction Act and The Prompt Payment Code are two of the directives that businesses need to be aware of and compliant with.

Penalties and reputational damage are the consequences if adherence isn't met. Both can have a damaging long-term impact on an enterprise.

Tracking payment and query dates is a challenge when done manually. Plus, different contracts may have different terms included for payment dates which can then become a minefield. How can those differences be tracked internally in a consistent manner across departments?

If businesses are omitted from The Prompt Payment Code, then they won't be able to bid for certain work. Being admitted back into the Code is a lengthy, arduous process in itself.

With new legislation being introduced all the time, how prepared are you as a business to keep on top of it?

### 4. Subcontractor default

The fourth area of payment-related risk, subcontractor default, is a complex one, stemming in large part from longstanding structural challenges in the construction industry. Traditional financial processes mean subcontractors face long and uncertain periods waiting for payment. This is a key challenge as their expenses for project work, such as payroll and materials, are outlaid long before payment is received.

According to recent research from PwC, Engineering and Construction (E&C) was the worst-performing sector in terms of receivables. Globally, the sector averaged 73 days sales outstanding (DSO), a measure of how quickly businesses are paid once goods or services are sold.

For subcontractors, cashflow problems can limit growth opportunities and even lead to business failure. Delayed payments and limited cashflow are a leading cause of bankruptcies in the E&C sector. In fact, subcontractors are more likely to fail in economic boom or recovery periods than they are in leaner times.

In a strong or rebounding economy, subcontractors tend to take on more work than they can handle, with cashflow challenges arising from payment practices compounding the resulting financial strain.

### Questions to ask:

- Does my organisation have the controls in place to prevent fraudulent payments?
- Can our team keep up with compliance validation?
- Do we have the required visibility to hold payments for compliance deficiencies?
- What impact would failing to meet UK legislation have on our business?
- Could my organisation easily withstand a significant subcontractor default?

## OVERCOMING THE CHALLENGES

The challenges of traditional construction payment management practices don't have to be here to stay. The key is recognising that best practice is rooted in a collaborative approach enabled by technology.

Construction projects by their very nature are ideally suited to this way of working. The front end of construction is already relatively well-served with collaborative software solutions. It's the back-end where it's often been neglected.

Every construction project requires the coordinated execution of a large number of interrelated activities by numerous participants, with all activity planned and tracked against timelines and budgets. Just as all building activity must be driven by a central plan, subcontractor payments are best managed using a single, shared, and centralised data set.

Cloud-based payment management software is the best way to achieve this and provides numerous advantages:

- Centralised and secure cloud data storage, accessible to all external and internal project stakeholders
- Version control for all documentation providing a single version of the truth
- Online workflows which help to enforce review and approval paths
- Greater transparency of data across all activities

These features all support a simpler, more efficient, and lower-risk payment process:

- Less time and money spent on financial admin
- More accurate and centralised decision making based on a consistent source of the right information
- Better control over cashflow and payment speed
- Better reporting and transparency across projects
- Improved collaboration and an enhanced capacity for investigating the root cause of challenges in the system
- Reduced risk, through better visibility and built-in compliance with regulatory changes and legislation

In this shared system, all stakeholders can work from the same information, eliminating duplicated effort, minimising errors, and simplifying the resolution of issues.

It's also an opportunity to improve internal and external visibility and communication. This helps to head off disputes, reducing delays and bolstering confidence in partner relationships across different projects.

### For more information please get in touch with:

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