

The Construction Executive's Guide to Modern Financial Management



 **THEOBUILD** |  **CONSTRUCTION DIVE**

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Getting paid may be the construction industry's biggest challenge. In fact, research from PwC found that construction companies wait an average of 83 days to get paid — some even as long as 180 days. No other industry faces such a long payment period or does so by also running on extremely thin margins.

But it doesn't have to be this way. While the construction industry has historically been resistant to change, a few key players are moving the industry away from the status quo by adopting technology that takes payments from inefficient and frustrating to quick and easy.

For one, the right financial management software should streamline the entire payment process, making the wearisome undertaking of getting paid a thing of the past for general contractors and subcontractors. Currently, the payment process for most contractors consists of spreadsheets and emails —

manual methods that often result in missing pieces that prevent payments from being completed as quickly as possible. Plus, lien waivers, compliance, and insurance issues further complicate and slow down the process of getting paid, leading to frustrations between all parties and in some cases costly lawsuits.

In addition, construction companies are challenged with controlling spend on projects and managing spend to stay within allotted project budgets. It is difficult for many contractors to manage cash effectively while also following the many compliance rules required of them. Technology not only simplifies and automates that process by giving visibility into spend and payments, but it also takes work off their plates. The right payment technology can eliminate the constraint of cash management, and streamline your business by removing manual administrative work, eliminating human errors and creating efficiencies across the enterprise for stakeholders.

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Technology uncomplicates the payment process

When TheoBuild CEO Jammil Handal entered the construction industry in 2014, he was surprised to see how far behind the sector had fallen.

"I had to get an eFax because somebody asked me for my fax number, and I thought, 'I don't think I've seen a fax since, like, 1998,'" he recalls. Following this experience, Handal realized the potential to improve the sector's dated manual processes, especially when it came to getting paid.

The construction industry is extremely complex, merging the management and flow of information from subcontractors, general contractors, developers, bankers and more. Adding to that is how the capitalization of construction has evolved, making real estate one of the largest industries in the United States. Today, asset owners such as banks or equity partners require all investments to be secured with provisions such as lien waivers that protect the integrity of the asset title. These provisions ultimately hold up cash flow, explains Thomas Priore, Executive Chairman & Chief Executive Officer, Priority Technology Holdings. Keeping track and in compliance with these provisions makes the payment process for the construction industry even more complex.

This is where technology comes into play.



"Companies can apply technology to validate activity and accelerate payments capabilities to collect, store and send money and accelerate cash flow," explains Priore. "Where we think that's really going to benefit the bottom line is that by having accelerated cash flow you can keep your employee base more stable, get work done faster, get suppliers paid faster, which of course deepens your relationship and your economic strength in how you're able to deal with them."

Currently, the industry's payment process is manual in nature, with money flowing back and forth through multiple layers, upwards and downwards from subcontractor to subcontractor to general contractor, and so on all the way up to the Mortgaging bank — and then back downwards. Any mistake that happens along this pathway, such as incomplete or incorrect lien waivers, is painful to resolve. And when it comes to payments, mistakes not only mean you can't get paid, but they can result in costly lawsuits.

"There's innate risk in every transfer of information that happens along the way," adds Handal. "Every project has literally thousands of details, a larger project probably millions of details — everything from the type of material you use to who signs off and who was paid and who wasn't paid and what the progress of the project is. Technology essentially offers a management of information from one piece to the other. That's really what everybody's trying to accomplish." So much so, that the industry has seen companies pop up that simply audit contracts and payments to ensure compliance and claim to help clients to recover hundreds of millions of dollars each year for their clients.

And when companies are able to manage the payment process by tracking all this documentation, it helps everyone get paid quicker and ultimately reduces their risk. Payment technology has the potential to make this flow of information as simple and efficient as possible by looking at the key friction point and de-risking it.

However, while the technology is there and ready, the challenge to get the industry on board remains.

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Moving away from the status quo

The benefits of financial management software are numerous, but only a small number of innovative and fast-growing construction companies are taking advantage. While the cost of construction software often is cited as one reason, the biggest factor is, in fact, penetrating the attitude of a culturally risk-averse industry. Most contractors have adopted the mindset of, “This is how we’ve always done it,” and look to their peers to make the first move.

“It’s easier to do nothing, and I think a lot of people just feel that way. It works, right? The process works, great buildings are going up, and great companies are really profitable. So, it’s just easier to do nothing,” says Handal.

However, as more companies adopt technology, they will become innately more effective and efficient, which ultimately makes them more competitive and profitable. This is particularly the case for more commoditized aspects or trades where the ultimate differentiator might be cost, reliability and speed.

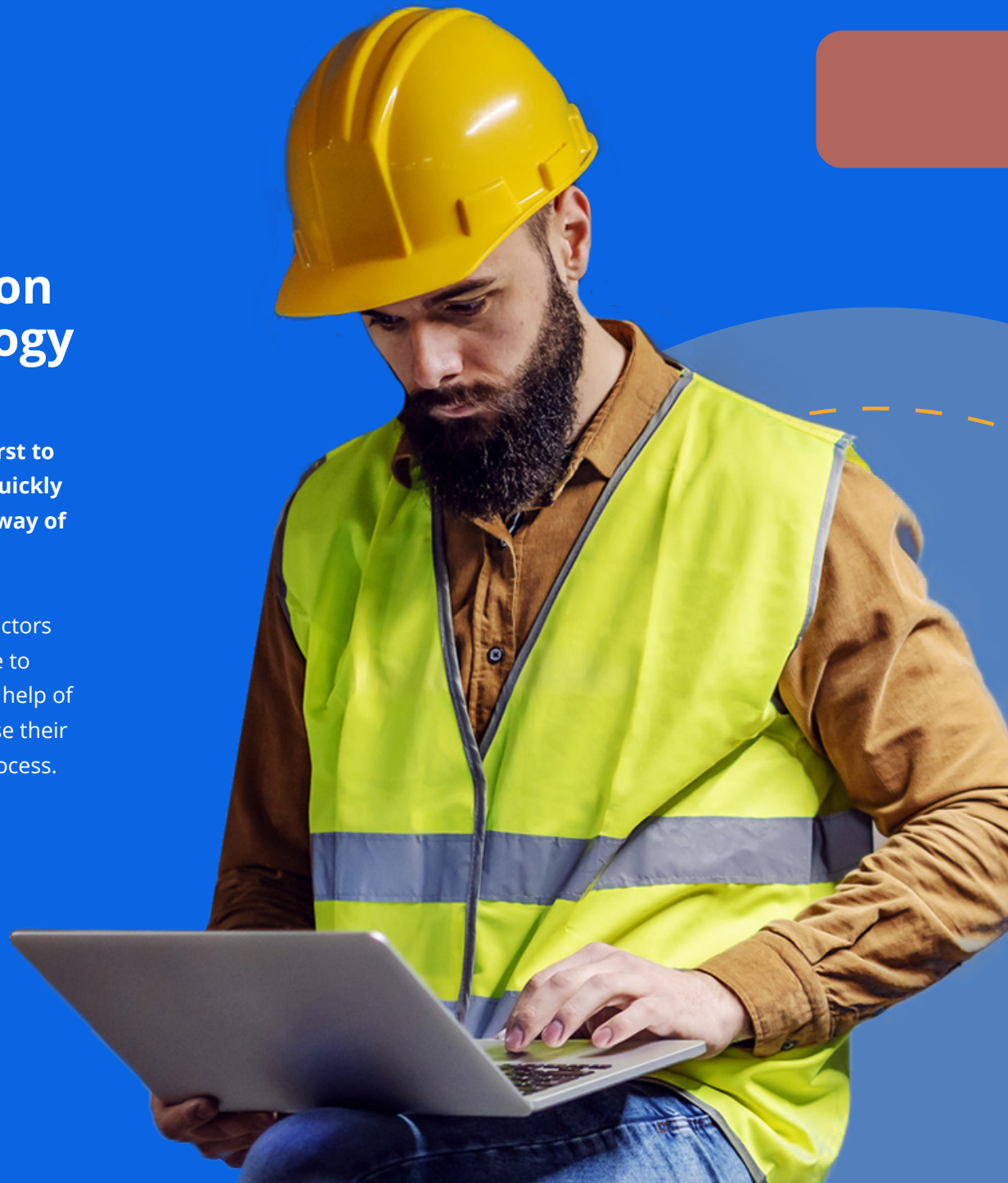
In addition, a more tech-driven construction industry is being born out of pure necessity. Supply-chain disruptions, labor shortages and economic swings require agility not usually found in the construction industry. Now more than ever, every business — no matter the sector — must be able to quickly change course.



Modernizing construction payments with technology

The construction industry may not have been the first to look to technology to solve its challenges, but it is quickly coming around to a more streamlined and modern way of doing business.

Payments are ultimately the leverage that allows contractors to ensure everything's done properly and in compliance to contract. It is the carrot at the end of the stick. With the help of payment technology, companies can drastically decrease their risk and remove much of the friction in the payment process.





ACCELERATING CASH FLOW

Payment technology also has the potential to make the industry more stable, by increasing efficiency and transparency while also accelerating cash flow. For example, if you're an operator and you have more certainty over cash flow and your balance sheet, you can plan better.

"In any company, the lifeblood is its cash flow," Priore says.

"Efficiency to manage the invoice process or embedding, not just this payment acceleration but also banking products, those are all great and they're going to improve on the margin, but the big opportunity here is transparency and acceleration around cash flow."

"Creating transparency and acceleration of cash flow through small or midsize companies is a comfort for any operator in managing their business. That in and of itself is at the heart of how payment technology is making this industry stronger," he adds.

MUTUAL BENEFITS

On the flipside, digitizing the payments process doesn't benefit only the contractor. There is great value for the financier or asset owner around transparency in how their cash flow is being utilized.

"At the end of the day, they're in a real estate transaction either to own it at the right price or as a lender to ensure they're not overexposed to the value of the property. Well, the only way to do that is to reconcile the balance sheet," Priore explains.

Payment technology allows both parties better control over the income statement, which can now include essential data that moves back and forth with every payment.

"They can see, 'Hey, what was this for? How did it get reconciled? What's the progress? Am I in line with my expectations of how much equity or debt I have exposed to this product or this project?' And that's worth its weight in gold as a risk manager at the end of the day," says Priore.

EASE OF ACCESSIBILITY

Payment technology is one way to marry the field to the back office. The challenge today is that they are extremely different worlds that are not always moving in sync.

Using mobile applications accessed through smartphones and tablets is one way companies are working to bridge this gap. Where there once was this idea that a business owner doesn't have the sophistication to manage mobile software, that notion is gone.

"Even though they're a small business doesn't mean they lack technology sophistication. The smartphone has changed that. No one uses a flip phone anymore, so computing not being in everybody's hands is a thing in the past," says Handal.

Priore adds that of his 250,000 merchants, 10% of them are in wholesale services, such as landscaping or plumbing, and they are already using mobile payment technology to manage their businesses.

SIMPLIFYING REGULATORY AND COMPLIANCE REQUIREMENTS

One of the biggest risks the construction industry faces when it comes to payments is failing to properly secure lien waivers. In construction, if you don't get paid, you can file a mechanic's lien on a building. The general idea is that contractors and developers have an obligation to do their work, and the owners have an obligation to pay.

"If you don't comply, you don't get paid," explains Bill Richmond, JD, Founding Partner, Platt, Cheema & Richmond PLLC, a leading real estate legal firm. "This is the most extreme, but if you don't comply, you don't get the leverage to help you get paid. The statutory lien process is meant to help you get paid timely and to show owners that they have some real skin in the game to get paid.

"Any contractor who wants to stay in business has to be on top of complying with statutory regulatory constitutional lien structures. If not, their competitors who are staying on top of it are going to be getting paid faster and paying less interest on floated dollars or lines of credit," he adds, noting that efficiently maintaining your lien waiver creates an advantage in the marketplace.

“Millions of dollars can hang in the balance on you failing to meet critical contract requirements for a loan in the construction process,” he says.

The system is designed in a way to not only make sure everyone gets paid but also so that the title of the building in the interest of the owner or the bank remains clean. In the event that the general contractor doesn't pay the plumber, a lien would go on the building. This means the building owner is now on the hook to pay the plumber to clean their lien. These types of disputes often result in lawsuits where the owner sues the general contractor. This is an expensive, time-consuming and difficult process to navigate — further adding to the complexities of simply getting paid.

“It's really a push and pull between different interests, different parties. You have the owners, lenders fighting with contractors and subs for their rights to who gets paid. And somehow with everybody's interest trying to be accounted for, you get a mess and everybody's unhappy,” says Steven Dimitt, JD, Partner, Platt, Cheema & Richmond PLLC.

“It's complex because it's balancing needs,” adds Richmond. “If you don't set deadlines and you don't set requirements, then an unscrupulous tradesperson will say, ‘I did a 100,000 dollars’ worth of work, and now I have a lien on your house.’ Well, they may not realize that the lien on your house triggers a default provision under your loan agreement, and now you're facing a foreclosure because someone decided to put a false lien on.”



Today, the complications lie around making this process as streamlined as possible, as staying on top of the construction industry's regular structure is essential in ensuring that dollars don't get lost. However, keeping up is an extremely person-intensive process — and the problem with humans is that they are prone to error.

"It's unfortunate, because the more manpower that is devoted to collecting dollars you've already earned eats into the contractor's bottom line. There really does need to be a lot of attention to it, and right now the best solutions, they're just human so far," says Richmond.

"If I was an in-house lawyer, advising a contractor or a GC about the value of using a technological solution that ensures accuracy, completeness and timeliness, it would be, 'We're going to pay lawyers less, we're going to get our dollars faster and we're going to get what we're owed with less hassle.'"

Bill Richmond, JD, Founding Partner,
Platt, Cheema & Richmond PLLC



Payment technology has huge potential in this area to improve the industry's processes. When both parties can see where the dollars are held, how they can get released, or what happens with the lien waivers, costly errors can be eliminated.

"We always advise our clients who we see are getting it wrong on the lien side that they need to establish best practices to make sure that trained, qualified people are there, or to reach out and find a system that from a technological standpoint will be able to ensure that they're complying," says Richmond. "Rather than paying for a lawyer, what you really need is ... a system in place that can answer all of these questions, dot the Is and cross the Ts, and make sure you get your lien protection."

Richmond adds, "If I was an in-house lawyer, advising a contractor or a GC about the value of using a technological solution that ensures accuracy, completeness and timeliness, it would be, 'We're going to pay lawyers less, we're going to get our dollars faster and we're going to get what we're owed with less hassle.'"



EMBEDDING PAYMENTS AND BANKING

The endgame for payment technology, and where the industry will find even greater efficiencies, is around the idea of embedding payments and banking. Most companies today are using some type of software to manage the day-to-day operations of their business. Up to now, those systems have been loosely linked to their bank, and to manage their workflow in the software, it must be communicated to employees who then have to take action. Someone needs to go into the bank account, for example, to pull out a payment, look at how payments are progressing and then validate it all.

“Imagine if you could just skip that step because it's all one thing,” says Priore. “You’re reducing time. You're getting clarity on what you have as a business owner or operator to conduct work. You can make decisions quicker, and you could do it with less staff. That’s going to change the nature of how modern construction operates.”

More than a one-size-fits-all approach

While the construction industry has historically been a hard sell when it comes to adopting new technology, the timing is finally right for growth in the sector. By marrying payment technology with existing technology already in place and making it intuitive for use on mobile devices, the barrier to adoption has been greatly reduced for small to midsize companies.

This more modular approach to technology is where Handal believes the future of payment technology lies in the construction industry.

“With the proliferation of open APIs, technology is starting to become much more modular. You're starting to see a lot of these smaller more specialized applications that can talk to each other and really give you a more best in class experience. For example having the best fitting estimating system that talks to your project management that talks to your accounting that talks to your payments etc.. Companies that will succeed are the companies that are as open to adapting to a changing tech landscape that is evolving quickly and accelerating,” says Handal.

This is a shift in mindset from 10 to 15 years ago when customized solutions were designed exactly to fit the needs of a company and where the right system was the one that did it all. These systems were extremely costly, and require a lot of upfront cost and risk,

many failing to provide any value even after the investment has been made. While this approach may have worked well for the biggest players in the industry, a \$20 to \$30 million company can't spend \$3 million on a software system.

The payment solutions of the past have, unfortunately, neglected small to midsize companies and the general appetite for technology adoption for anybody who doesn't have an IT department.

The modularization of technology is a big deal for those companies. “Being able to have a bunch of systems that talk to each other, that you can look at, adopt and start working with is a big change for the better,” Handal adds.

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Jammil Handal, TheoBuild CEO



The future of construction payments

If you look back 20 or 30 years ago, every construction drawing was being printed. You would literally take the plans out and walk the property. But now, everything has moved to PDF. Similarly, there will be a general evolution with payments being pushed forward by a younger workforce.

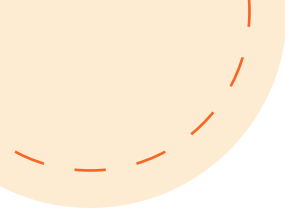
“It’s moving fast in the right direction. There’s a lot happening, and it’s kind of the right moment,” says Handal. “A younger workforce that grew into their professional careers in the era of Venmo and PayPal does not really know what to do with a paper check and are demanding more and more to handle everything more digitally.”

And while not everybody is there yet, Handal predicts competitiveness in the business will be a major factor in the adoption of technology in the next five to 10 years.

“There aren’t huge margins in construction, so companies that can do more with less will be able to decrease prices and just be better at what they’re doing,” he says, adding that companies that retain the same old mindset will be less efficient. And in an industry plagued by inefficiencies, it is hard to imagine those companies will survive.

This is not to say that there is not going to be a place for the mom and pop companies in construction that will continue doing great work while remaining in their old ways, however this will be a barrier to scaling these companies, a barrier that will get exponentially bigger in the future.





“They still can work the same way, but I don’t think any of the major companies or the upcoming companies in any sector are really going to achieve their goals without heavy technology adoption,” Handal adds.

Adopting technology in the long run just makes good business sense. If you look at the uncertainty of the last few years, the Covid-19 pandemic has essentially been a wake-up call for many companies reluctant to change. Labor shortages, supply-chain disruption and the costs that come with these challenges ultimately have been passed down to owners. Interest rates also continue to rise, further squeezing the cost of assets and capital.

“Anything we can do collectively, across any staff, to be more efficient and more effective is going to be a big deal, particularly now in such uncertain times. We need to continue to be able to adapt,” Handal concludes.

We are beginning to see that sticking to the status quo will come at a great cost. Choosing not to adapt is no longer an option. As more contractors move away from the way they’ve always done it, a modern approach to financial management is emerging. Early adopters will pave the way for an industry ready to change and move forward more efficiently and effectively.





THEOBUILD

A simple, cloud-based based solution that focuses on facilitating the collaboration between general contractors and subcontractors to ensure real time accurate reporting that is not overly cumbersome. Theo Build is designed to be a contractors' one-stop shop for project financials, from budgeting to invoicing to payments.

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