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MANAGING THE PAYMENT CHAIN: *Collaboration, Not Control*

On construction jobs, where company leaders must work externally across multiple stakeholders, great leadership must transcend the "command and control" mindset.

This is especially true with construction payment – which is typically a complex, compliance-riddled powder keg in which everyone's money is on the line.

Ruling jobs with an iron fist (e.g., tight and unwavering control over project funds) usually does not prove to be beneficial.[1] In fact, creating such adversarial environments can actually prompt issues involving liens and lawsuits. Further, expending time and energy to put out these fires can take away from other more important initiatives.

The same idea applies to "managing up" the payment chain. Withholding documents or attempting to assert leverage through liens or adversarial proceedings can create a potentially problematic climate for everyone involved.

This article is the first of a construction payment-focused series and will discuss the advantages of proactively and collaboratively managing payment via specific, proven methods.

Payment Chain Management

Construction is typically fragmented; for all parties involved in a project to receive payment, funds must make their way down a "chain" from one party to the next, starting with the owner or lender. The prime contractor receives payment from the owner or lender, pays its subcontractors and suppliers, and so on down the payment chain. If any link in this chain falters, parties that follow will suffer.[2]

The general rule is that the further down a party lies on the payment chain, the riskier receiving payment becomes.[3] In order to receive payment, everything atop the chain must go according to plan.

Power lies at the top of the chain, and how those parties wield their power can strongly impact a project's success.

Consequently, some may choose to take advantage of their high positions in payment chains. They may use retainage, rely on burdensome or even unfair lien waivers, or demand change orders at any given moment, all via leveraging of project funds.[4]

Fortunately, legislation affords protection for lower-tiered parties in the form of mechanics lien rights, bond claims, and other legal remedies.[5] Because these parties yield powerful tools, there are inherent risks in using project funds as bargaining chips. After all, cash is tight in our industry, and particularly within the specialty trades.[6] Withholding payment from a subcontractor can spark a dispute, often only taking one claim for an entire job to postpone.

Thus, the need for payment chain management is essential. A contractor atop the chain must ensure everyone below is receiving and making payments, since any hiccup can bring a job to a halt.[7] Meanwhile, timing payments to go along with job progression is also crucial.

Creating balance is tricky, to say the least. So, what is payment chain management? It's setting the tone from day one. It's doing what your company does best. And, it starts with communication.

Managing for Good Outcomes

Payment chain management means managing for good outcomes. While success may look different for every stakeholder, keeping a project on schedule and payments on time is a good place to start. While this may seem simple, many construction participants play not-to-lose (manage and shift risk) rather than to win (manage for good outcomes).[8]

It may be more helpful to illustrate the opposite of what "managing for good outcomes" entails. Abusing leverage is *not* managing for good outcomes. Keeping information from lower-tiered parties is *not* collaborative. Resting on protection-first, "CYA" principles hardly sets up jobs for success. Instead, these actions can create division on jobsites, forcing each link in the payment chain to watch its back and try to get the better of the next link in the chain.[9] When every stakeholder constantly works to insulate themselves and shift risk, project collaboration (and therefore, project efficiency) goes out the window.[10]

So how can contractors play for the win and manage for good outcomes? They can seek to switch from protection-first to collaboration-first approaches.[11] And, effective communication is the glue that supports productive collaboration.[12]

Of course, sub-tier buy-in starts at the top. For successful collaboration on the jobsite, contractors must also participate in sharing information. To truly collaborate, everyone comprising the payment chain must feel their voices are heard.[13]

SET Framework

A collaboration-first approach can be a good path toward cultivating a new style of construction project management. However, issues can arise that block a contractor's ability to manage for good outcomes, which can force everybody back into a protection-first mindset.

Here are three common collaboration killers in construction projects, for which to plan and prevent:

1) *Fear* – breeds paranoia, which can lead people to reactively rely on protections and leverage.
2) *Friction* – extra protections require paperwork that can create overhead and relationship frictions. This can erode trust and create an overall negative outlook.
3) *Fires* – the resulting negative outlook and work environment can spark fires that can be impossible to extinguish, breeding "wars" and entrenching all parties into defensive positions.

These issues can be prevented by using an established framework to remain focused on "good outcome-based" project management. This framework can be remembered through the acronym, "SET":

See everyone on the job *(reduces fear)*

Easy paperwork *(reduces friction)*

Talk it out *(reduces fires)*

By fully embracing the SET method, it can be easy to transition from a protectionist mindset to a collaborative one.

Reduce Fear by Seeing Everybody

Using a framework developed by psychologists,[14] former Secretary of Defense Donald Rumsfeld noted that with respect to the intelligence regarding weapons of mass destruction in Iraq, there were "known knowns," "known unknowns," and "unknown unknowns" with the latter being the most problematic.

Construction projects can be viewed through a similar lens. When managing project finances, the "unknown unknowns" create the thorniest issues. How can one prepare for what one can't anticipate?

Any party on a project, including unknown parties and parties at the lowest tiers, can cause problems for the entire payment chain. Thus, it's easy to see why failing to account for all project participants could be disastrous for mitigating problems and managing for good outcomes. Poor visibility exacerbates problems and creates fear of the unknown.

The solution seems simple; just see everybody on the job! But it's actually more complicated. Construction sites are home to numerous participants, and it's hard to identify them all unless directly contracted with them.

Typically, the GC doesn't have much (if any) control or visibility below their sub-subcontractors. That lack of visibility works both ways, too. If the GC can't see past the second tier, how much visibility does a fourth-tier subcontractor have up the payment chain? Not much.

Fortunately, there are concrete steps to take to see everyone on the job:

Raise Your Hand

"Raising your hand" means giving notice to other project stakeholders. Let them know that you're on the job and the work or materials you will provide. Sometimes this may take the form of a legal notice (e.g., a notice of commencement or preliminary notice), but it can also be like sending an e-mail.

Providing this information is a service to other project participants. Consider it the "Golden Rule" of construction visibility. If you want to know who else is on the project, make sure everyone else knows who you are. Preliminary notices were specifically designed to help paint a picture of everyone on the job, which raises the next point.

Ask Others to Raise Their Hands

There is so much fear and desire to maintain leverage on construction jobs that many contractors and suppliers are fearful to raise their hand. Suppliers may be scared to jump over their customer and "notify" the GC and property owner that they're on the job. This fear can be overcome by asking for other participants to raise their hands.

Leverage the Available Tools & Data

Finally, since construction is so fragmented, the "raise your hand" process might not address every data gap. While collecting this information can be difficult, there are tools and databases available to help and illuminate blind spots. This information is crucial to the ability to manage for good outcomes, so all available tools should be utilized.

Reduce Frictions by Simplifying Paperwork

Friction in the construction payment process causes trouble. Often, those troubles trace directly back to frustration with paperwork.[15] Paperwork associated with construction payment is often complex, confusing, tedious, and overwhelming, but it doesn't need to be. Much of that complexity can be leftover consequences of previous protection-first mentalities.

Collaboratively managing the payment chain opens the gates to easy paperwork. When payment paperwork isn't used for unintended purposes, it can be streamlined. Then, most common problems (e.g., needing a lawyer to understand it, positioning for leverage, non-standard documents) can be avoided.

Simplifying paperwork will benefit everyone on the project. Here are some tips on how to do it:

- *Don't invent requirements* – If it's not actually required, strip it out.
- *Challenge the company status quo* – When something stops paperwork from being easy, ask "Why?" Don't be satisfied when the answer is "because that's how we've always done it."
- *Challenge attorneys* – Although attorneys might create protectionist requirements, these are not always actual requirements. And, when they're not actual requirements, try referring to the above.
- *Don't posture through paperwork* – There may be an opportunity to gain protection through certain documents, but is it required? If not, is it worth it? Or, would streamlining the process be a better solution?

When these steps are followed, it can become much easier to streamline processes. It can also become easier to embrace tools that take efficiency even further. Automation, electronic documents/electronic signatures, and integrations can dramatically reduce paperwork overhead. Documents can be automatically requested, generated, signed, and sent.

SHARING INFORMATION AND WORKING WITH OTHER STAKEHOLDERS RATHER THAN AGAINST THEM (AND THEIR LAWYERS) CUTS OUT THE NOISE AND HONES IN ON THE PURPOSE: TO BUILD BUSINESSES AND BOTTOM LINES.

Reduce Fires with Channels that Optimize Communication

Managing the payment chain for good outcomes means that fires must be dealt with quickly and in a collaborative manner, before they turn into full-fledged conflagrations.

Disputes between any two parties can have a ripple effect, spreading to other parties not directly connected to that particular fire, or even *on that job*. Because these effects can be devastating, it is imperative to create pathways to work things out. Poor communication starts and exacerbates most fires in construction payment. The straightforward way to combat these potential fires is through open and direct communication.

Construction projects are complex, so establishing clear and efficient communication can be a complex goal. The more parties that must relay a message, the more difficult communication becomes. Certain activities that look like communication (i.e., a single phone call or e-mail to one other stakeholder on the job) frequently don't result in the message actually getting delivered where it needs to go. Just as often, the messages that *do* get delivered are the messages that are worthless or even counter-productive. (Have you ever played a game of "Telephone"?)

Effective communication on a construction project can be managed by knowing both what to do and what to avoid.

Things to avoid include:

1) Involving lawyers or other adversarial parties like collection agencies;
2) Waiting to communicate until it becomes forced or absolutely necessary; or even worse,
3) Staying silent.

Many symptoms of bad communication can be remedied with additional attention. Instead of looking to lawyers or collections to communicate aggressively, make sure there are channels available to communicate directly with other project participants. Instead of waiting or remaining silent, talk to somebody in person or on the phone. It's a lot easier to talk it out than it is to exchange e-mails or letters. Instead of framing options as "either/or" situations, seek to expand the options and see what alternatives may be available.

These collaboration killers form the status quo and stand in the way of better management. Managing the payment chain toward good outcomes and away from these issues is the next step in construction management.

Conclusion

Margins are narrower than ever before, and inefficiency takes billions out of the construction industry every year. Efforts are wasted collecting project information and posturing.[16]

What's more, the construction industry might be the most litigious in the country.[17] This has led to complex documentation and frustration along the payment chain. It's time for a change, and contractors are positioned to bring it.[18]

Creating collaborative payment chains will benefit all stakeholders. It will empower subcontractors and suppliers to focus their time and energy on their craft. When they don't need to worry about whether payment is coming or if their customer will hold their paycheck for ransom, these parties are free to do their jobs.

Instead of hiding project information and dodging preliminary notices, it's time to embrace them as opportunities to communicate and learn about projects. Embrace the challenge of construction by controlling the chaos, which is controlled by the entire payment chain working toward the same goal, rather than stakeholders battling each other over risk-shifting and finger-pointing.

Today's construction environment requires more than just parties who manage the job through opening (and closing) their wallets. Hiding behind contracts, retention, and legalese won't move the bar.

The days of risk shifting and forcing will through retainage are nearing their end. It's time to play for the win. It's time to manage the payment chain rather than wrestle it into submission. Sharing information and working *with* other stakeholders rather than *against* them (and their lawyers) cuts out the noise and hones in on the purpose: to build businesses and bottom lines. ■

Endnotes

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