

BETTER PAYMENTS FOR BIGGER PROJECTS

HOW TO REDUCE RETENTION AND GET PAID FASTER

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Winning a large contract is great. But *getting* paid for a large contract is another matter. We recently started using a new strategy that helps us get paid better and faster. Here's how.

Many large builders withhold 10 percent of your total sale as "retention" until the job is completed and until the owner has paid them. On a big contract (or multiple small ones), the retention can amount to a large amount of money that is not available to run your business.

The typical scenario

Here's how the retention model hurts. We win a contract for a \$200,000 job. The material costs are \$120,000, and labor and profit make up the balance. We order the doors in March. They arrive in late April, and we have to pay the supplier \$120,000 by late May.

We install phase one of the project in May and bill for \$80,000. The contractor pays 90 percent of that (\$72,000) in early July, and he keeps the 10 percent retention. By that time, we've already had to pay \$120,000 to the supplier, and we're almost \$50,000 in the hole.

We install phase two in June and bill for \$80,000. The contractor pays 90 percent (another \$72,000) in early August. We use that payment to cover the \$48,000 balance of the material costs and \$24,000 of our labor costs.

\$20,000 left hanging

We install the balance of the job in July and bill for the final \$40,000. In early September, we get paid 90 percent (\$36,000). At this point, we've been finished with the job since July, but as of September, we've received only \$180,000 of the \$200,000 owed to us.

The contractor continues to hold the retention of \$20,000 until 45 days after the *entire job* is completed. So if the job finished in November, we would not receive the remaining \$20,000 until January, or six months after we had completed our job. Not good, right?

Solving the problem

At Raynor Hawaii, we have come up with a way to reduce our exposure to this problem of retention. We solve the problem in the bidding stage.

When we bid a job, our bid clearly states:

- *Material to be purchased by purchase order = \$140,000 (which might be \$120,000 cost + \$20,000 markup)*
- *Labor to be performed under contract = \$60,000*
- *Total job cost = \$200,000*
- *Note: Material and labor must be purchased together.*

The purchase order approach

Then, we get a material purchase order for \$140,000 and a labor contract for \$60,000. We also get a letter from the supplier that states, "Due to the specialized nature of the product and being custom-built for this job, a 50 percent deposit is required before fabrication can begin."

Expect the builder to turn you down when you ask for a deposit. Explain that it is a requirement from the *material supplier*, not you. The supplier's letter that requires the deposit has allowed us to collect the deposit on every job.

We receive a joint check payable to us and the supplier for \$70,000 before the order is placed. But remember, this payment is only for the material on the purchase order, so it is not covered by the contract terms *that include retention*.

Collecting more, faster

With this new approach, here is how the job might go. We collect the \$70,000 deposit when we order the material and give the check to our supplier in March. The material arrives in late April, and we bill the contractor for the remaining \$70,000. We then have until late May to pay out the remaining \$50,000 of the \$120,000 material costs.

This invoice generates a \$70,000 payment in early June. Since it's a purchase order, there's no retention. So, now we have collected \$20,000 more than the material cost by the first payment.

We install phase one in May and bill for \$24,000 labor as under the contract. They pay 90 percent (\$21,600) in early July, and they keep \$2,400 as retention. In June, we install phase two and bill for \$24,000 labor. In early August, they again pay 90 percent (\$21,600). We install the balance in July and bill for the remaining \$12,000 in labor costs. This invoice generates a 90 percent payment (\$10,800) in early September.

3 percent vs. 10 percent

With this approach, the total retention is only \$6,000. If it is paid in January (as in the example above), the retention is a very doable 3 percent of the overall job. This is much better than a \$20,000 retention, or 10 percent of the job.

This strategy of splitting our bid into "Material on a purchase order" plus "Labor under a contract" generates multiple benefits. It allows us to pay our own costs quicker, limit our exposure to potential non-payment, and collect more rapidly and effectively. ■