Solving Cost Control With Proactive Spend Management

Addressing financial inefficiencies in your construction company

BY JOE TURNER

Construction owners, managers and supervisors at every level are familiar with two of the most important factors that affect profitability when operating a construction project: efficient cost control and knowing your cost versus budget in real time. Ask yourself: What percent of the cost going through your company do you feel you understand and have control over the spend? What area of spend do you feel has the least control in your business? In discussions about cost, what is included? Cost can mean many things in construction. First, there's direct cost and indirect cost. Then within these two, there are many categories. For indirect costs, there's office overhead, salaries of employees who may be on several jobs and many other things that fall outside the scope of this article like insurance, permitting, licenses, bonds, etc. For direct cost, there's labor, permanent material, temporary material, equipment, small tools and supplies, travel, project office expenses and more. The focus of this article is all the direct costs other than labor and permanent material which can sneak up and bite a construction company if it doesn't get the attention it needs from the start.

A high-level look at the construction industry shows the magnitude of inefficiency. The total construction industry value comes in at over $1.5 trillion dollars. If it is estimated that miscellaneous construction expenses will account for 5% of a project's total on an average-sized job in most sectors of the industry, that's over $75 billion dollars of expenses that contractors must deal with each year in the U.S. It's 10 times that globally.

This equates to over $200 million worth of construction project expenses that must be controlled and tracked every single day in the U.S. construction industry. Most of these miscellaneous expenses will be made with a card or purchase order and will need some type of approval and reconciliation process to handle that cost appropriately.

Efficiently controlling cost can make your job as a construction professional much easier and less stressful. We've all been in a quarterly review and seen budgets exceeded when they should be closed out because the work is complete, or found cost coded to the wrong place causing a false alarm for that area of a project, or we are in the green only to have some type of cost hit a job too late, pushing us into the red for that area. How do we solve this?

Historically, cost control becomes cost cutting and restricts employees from getting what they need to perform their work. I'll tell you that in most cases when construction companies try to solve cost control this way, it has the opposite effect. This process doesn't scale. Just like paper purchase orders and keeping up with paper receipts don't scale.

For example, a strict purchase order policy may seem like a good way to eliminate frivolous spending but doing a purchase order for anything and everything can be very inefficient. If members of your project team are spending most of their time creating, approving, reconciling and paying purchase orders and invoices then you're doing something wrong. Their time spent is costing your company far more than what you think a less stringent company credit card program might cost.

Tying purchase orders back to the correct budget can be problematic as well. When the vendor doesn't break up the invoice properly or include the correct PO numbers, then the process starts all over again. Doing work twice is a cardinal sin in construction. Let's not double handle our data.

In a perfect world, we plan for everything and stay out in front of it. But a perfect world doesn't exist, and there will be items that need to be purchased that we couldn't plan for almost every day. Some of these are obvious like fuel and travel, but the rest of it can be hard to get our heads around beforehand. Also, most of our employees are not accountants. Most are highly skilled field supervisors, craft foremen, engineers and project managers. All of whom are extremely good at building amazing projects, doing it safely and getting the job done on time and under budget. However, not too surprisingly, expense management is often the last thing on their minds. We can't expect them to promptly expense each cost item without a system that makes it easy.

Spend management goes beyond traditional expensing and encompasses things like budgeting, digitizing accounts payable (AP) and accounts receivable (AR) and bill-pay processes, issuing controllable physical and virtual credit cards that can be tied directly to budgets, and automated reconciliation workflows that save days of work at the end of the statement period.

Instead of preaching to our teams that they should plan their work better over and over and over, it would be better to set up a solution, or framework, that allowed for these everyday cost-inducing situations in a controlled, efficient manner that we could track and reconcile as needed. That type of solution is exactly what I'd like to propose, and that's what brings us to a new term in the construction industry: spend management.

Spend management has become common in other industries that are tech-forward and progressive. It goes beyond traditional expensing and encompasses things like budgeting, digitizing accounts payable (AP) and accounts receivable (AR) and bill-pay processes, issuing controllable physical and virtual credit cards that can be tied directly to budgets, and automated reconciliation workflows that save days of work at the end of the statement period.

How is spend management different from traditional cost control? First, spend management is proactive. We all agree that doing expense reports a month after the purchase happens only to see that cost on a job another month later is not a healthy practice for a construction company. Spend management is that framework that allows employees to get what they need to do their job whether it's paying a bill, fueling up or buying tools, and still be able to control, track and reconcile all that cost. Not only that, but to then see that cost as it happens in real time, viewing reports, monitoring trends, to help us make the right decisions before it's too late. This can make all the difference in profit or loss. How is that possible? First, tie the company's budgets to the mechanisms used to purchase. Then automate the reconciliation process as much as possible to categorize cost either beforehand or right after a purchase takes place. This will allow for real time insight into spending and how cost is hitting your company.

Proactive spend management means setting up card controls, limits and permissions, construction budgets, cost codes for construction project purchases, and other categories like fuel. Do this before the purchases are made so each transaction is expensed at the point of purchase instead of at the end of the month. Another common phrase in construction is using the right tool for the job. Use a purchase order (PO) when it makes sense. It's still a best practice to use PO's and committed costs, but don't force a PO system when physical or virtual credit cards make more sense. The key is knowing when to use what. What about annual budgets for things like travel and other non-purchase order spend? Of course, that's still a great thing and should continue. But now you can make those annual budgets even more powerful by assigning the correct credit cards and categories to them.

We can look specifically at the time it takes to reconcile company credit cards, purchasing cards and fuel cards to see that it can quickly make a difference. Many companies continue to use a process where someone manually codes and tracks down a paper receipt for every charge on the statement at the end of the billing cycle. Some do this weekly, some biweekly, some monthly. This is a labor-intensive, inefficient use of company time that can be automated. We would never let this kind of thing pass with labor on the job, right? Neither should we let it fly with our back-office process. By the way, "approving" an expense report after the fact doesn't really mean you're approving anything. The cost has already hit the company, you just haven't allocated it to the correct place yet.

Modern solutions allow you to assign cards to proper budgets and tag charges as needed right when they happen with images of the receipt and cost code which allows us to basically eliminate the manual reconciliation process altogether. A great way of capturing this information right when the purchase happens is via text message. This way, if you have a cardholder that doesn't want to go into a mobile application, they could simply respond to a text message and be done. With a platform like this, you will be able to do things like have your cardholders request for more funds when needed. This allows you to implement the limits and controls that you feel comfortable with while still having a quick and easy way to give someone approval for a one-off, large purchase, like when that piece of equipment breaks down and stops the whole job, and you don't want to be waiting on a purchase order to go through. A few other things to look for in a spend management platform are ease of use, real-time ledger updates and accurate record management. Spend management doesn't replace the need for an accounting suite or enterprise resource planning (ERP), but it integrates with and compliments it. You should be able to pull data like cost codes and budget information and push reconciled transactions to and from your ERP.

Construction deserves elegant solutions like these that are already becoming more common in other industries. Furthermore, construction companies need their own, industry-specific solution to control cost with spend management. A powerful spend management solution could be the most important tool in your company. ▲

Joe Turner worked as a project engineer for nearly a decade before co-founding Vendrix, a spend management solution uniquely built for the construction industry. Vendrix provides tools like controllable company credit cards and automated expense management, so business owners see savings through a combination of work hours saved, real-time controls on spending and no fees or cost whatsoever for the cards and software. Visit vendrix.co.