

Boosting profitability through effective change orders

Implementing a disciplined and effective change order process based on understanding and applying certain pricing principles can go a long way in helping construction contractors improve profitability and safeguard their reputations.

Successful businesses are not necessarily those with the most creative and visionary ideas. Rather, they are companies that have cultures that encourage and reward people who are disciplined in thought and action. Construction contractors are no different. The profitability of a construction business is directly linked to the discipline of its people, from top management personnel all the way down through on-site project managers. How a contractor uses change orders directly impacts his or her profitability. Changes, particularly those initiated by the customer, are something every contractor has to deal with. Although simple in concept, change orders, when handled ineffectively, can result in lost profitability and ill will toward the contractor.

Contractors are like everyone else in that they want to do a good job and please their customers. Stopping to get written approval for every change during the construction process is sometimes seen by the contractor as potentially detrimental to his or her relationship with the customer. Often, the contractor's mentality is to "Just get the work done and we will negotiate the price and terms in good faith later," or "We just don't have the time to do it now."

This "do it later" approach often leads to a huge amount of time (i.e., lost profitability) spent on the back end of a job trying to resolve disputes (i.e., potential damage to the contractor's reputation) that could have been avoided if changes were dealt with in writing before the work was done to ensure that the contractor and customer agreed on and understood the scope of work and price for the proposed change. Many disputes between contractors and their customers arise simply because they honestly had different perceptions of the requested changes.

Understanding the emotions of pricing psychology can help to implement an effective change order process, boost a contractor's profitability, and enhance the business's reputation in the eyes of its customers.

Two aspects of pricing psychology every contractor should take into account when putting change order procedures in place are price leverage and payment resistance. Price leverage is not so much an advantage held by one party over the other as it is a question of who has the most – or least – price sensitivity at a given time. Prior to any work being done the contractor typically has the leverage because the customer either needs or wants the requested change. This is the time when the contractor has the best opportunity to receive the maximum amount for the requested change and improve the profitability of his or her company. After the work is done the price leverage then shifts to the customer and the contractor can be left scrambling to recover whatever the customer is willing to pay.

Unwillingness to pay, or payment resistance, is often the direct result of the customer not feeling empowered in the change order process and being caught off guard. Without upfront timeliness the customer is not given the opportunity to approve the terms of the change order or perhaps modify them if they are not what they expected. This sense of control is extremely important to the customer and when not granted, can leave the customer feeling disrespected. Furthermore, some customers whose contractors do not put change orders and accompanying price additions into writing might assume that requested changes, especially small ones, are included in the overall contract. Such customers are often caught off guard when a bill arrives very late – and larger than they expected – after the work is completed. This is where a contractor's reputation and customer relationships can really be damaged. No one likes to be surprised, especially when it comes to money.

Executing change orders prior to work commencing is the most effective way to maximize profitability, overcome payment resistance and build good customer relationships.

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