



WHY LOWEST AVERAGE INVOICE PRICE

MAY NOT BE THE BEST WAY TO EVALUATE YOUR HVAC SERVICE PROVIDER

In today's competitive market retailers are searching for new ways to evaluate their vendors and cut costs. An increasingly popular way for facility managers to evaluate and select HVAC contractors is by analyzing the average invoice price of the service calls performed by a specific contractor.

Contractors are then selected based on the lowest average price of the invoices. While on the surface this may appear to be a legitimate form of evaluation, the information can be deceiving and in most cases when compared to a total cost model is more costly to the customer in the long run.

This white paper will examine some of the pitfalls of evaluation by lowest average invoice pricing and why it may not be the most cost effective way to choose and evaluate an HVAC contractor.

Contractor is aware he is being evaluated by lowest average invoice:

Many times if an HVAC service provider is aware that lowest average invoice is being used as a form of evaluation, they may be inclined to make multiple service calls instead of thoroughly inspecting the source of the problem and making the proper repair all at once.



Symptoms of the problem may be addressed with a short term fix approach with a plan to return at a later date to address the actual problem. This allows a major repair such as the cost of a bad compressor to be averaged over several visits, thus lowering the average invoice amount while increasing the amount of visits and the total amount spent on that unit.

According to Joe Sandor Professor of Supply Management at Michigan State University “when it comes to building solid relationships with suppliers, what gets measured gets done.”¹ Managers should ask themselves what am I measuring, and do the results coincide with my departmental and corporate goals. If we analyze the lowest average invoice scenario we often find that the results produced are diametrically opposed to the goals of the organization which in most cases is to repair the problem at the lowest total cost to the company. Please review the following example.

¹Michigan State University (2010) What gets measured, gets done - Executive Briefing

Low average invoice

Customer places a service call because his AC system is not cooling properly. The contractor arrives and determines that the system is low on refrigerant. The contractor knows that he is being measured on the lowest average invoice price so he fills the system which temporarily fixes the problem. His incentive is to keep the invoice low and that is what he does. This technician has no reason to look beyond the short term and repair the leak which will fix the problem long term. Instead, because of the low average invoice measurement method his incentive is to keep the cost of the call as low as possible which will ultimately lead to more calls and higher total costs. After the temporary repair, the unit is now operational with the cost for the first call of \$200. Due to the slow leak in the system, over the next year the contractor is dispatched another three times at a total cost of \$800. Ultimately the contractor is called once again for a fifth time to address the same problem. This time however, due to the repeated lack of refrigerant the compressor has failed and needs to be replaced at a cost of \$1,500.

Call 1: \$200
Call 2: \$200
Call 3: \$200
Call 4: \$200
Call 5: \$1500



Total Cost: \$2,300
Average Cost per Call: \$460



Fix it Right the First Time

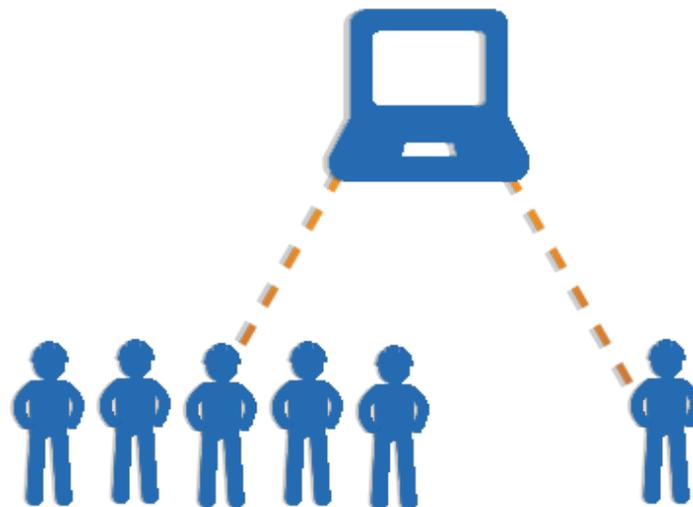
In this scenario the contractor is not measured by the cost of the lowest average invoice method. This allows him to repair the source of the problem which is a leak in the system. To repair the leak and eliminate the problem the cost of the service call is \$750. While this increases the average cost per visit it greatly reduces the total cost of the repair.



Call 1: \$200] Total Cost: \$750
Average Cost per Call: \$750



As you can see from the previous example, the measurement tool of lowest average invoice is actually dictating the actions of the contractor and the customer is being overcharged by \$1,550 for one unit. When multiplied by thousands of units over hundreds of locations this can be extremely costly to an organization.





COST OF GENERATING MULTIPLE INVOICES



Another hidden cost in the lowest average invoice method is the cost to the contractor and the customer to process all of this additional paperwork generated by multiple invoices.

What many companies fail to realize is there is a cost associated with generating invoices which in most cases can exceed \$8.44 per invoice. Information based on studies by American Express, Ernst & Young and Etransactus an automated billing company shows that it costs the average company between \$8.44 and \$12.44 per invoice to generate the invoice and capture payment.²

“Generating invoices and collecting payments has traditionally been a labor intensive process that costs American small businesses millions of dollars every year,” says John Jhong, Chief Executive officer of Etransactus.

“Our research shows that while the average cost per invoice is just under \$8.50, the process may cost some businesses far more -- as much as \$12.44 per invoice. For example if you process just 1,000 invoices per year, that’s an annual cost of \$12,440. The HVAC contractor must somehow recoup the additional overhead costs of invoicing and will need to pass this on to you the customer, which only inflates the cost of the service. This does not however take into effect the cost to the customer to process this additional paperwork.

These are just a couple of examples to consider while developing an evaluation and selection program for your HVAC contractor.

²American Express/Ernst & Young and Etransactus. True costs for the complete billing cycle.