

WHY CONTRACTORS FAIL

Surety bonds provide prevention and protection.

Construction is a complicated business that faces ever-changing conditions. Those who are not prepared or capable of meeting these demands may ultimately fail. BizMiner, a company providing industry analysis to small and large businesses, reported that of the 850,029 building (non-single family), heavy/highway, industrial buildings/warehouses, hotel/motel and multifamily home construction and specialty trade contractors operating in 2004, only 649,602 were still in business in 2006, a 23.6 percent failure rate.

Every year, thousands of contractors, whether in business for two years or 20, face bankruptcy and business failure. These firms leave behind unfinished construction projects—and billions of dollars in losses to project owners and taxpayers. Public and private construction project owners can mitigate the risk of contractor failure by requiring bid, performance and payment bonds.

Surety bonds provide financial security and construction assurance to project owners by verifying that contractors are capable of performing the work and will pay certain subcontractors, laborers and material suppliers. This is especially important on public projects where taxpayers' dollars are at risk. (For more information about surety bonds, see "S,M,L,XL: Surety for Every Size Contractor," page 62.)

Surety companies are well positioned to analyze and manage construction risks because of their close relationships with contractors and surety bond producers. The surety bond producer works with contractors to prepare the necessary documentation for the rigorous prequalification process

TOP FIVE REASONS CONTRACTORS FAIL

INDICATOR

PERCENT OF CASES WITH INDICATOR

Unrealistic Growth	37 percent
Performance Issues	36 percent
Character Issues	29 percent
Accounting Issues	29 percent
Management Issues	29 percent

conducted by the surety company. Through the prequalification process, the surety verifies the contractor's ability to perform the contract and fulfill its financial obligations (taking into account the contractor's current and projected commitments).

Prequalification is an in-depth process, which includes a complete review of financial statements, capacity to perform, organizational structure, management, trade references, credit history and banking relationships. Before a surety company will issue a surety bond, it must be certain that the contractor runs a well-managed, profitable enterprise, deals fairly and performs obligations as agreed.

Because preventing contractor default is a key component to the surety business, surety companies and surety bond producers are experts at spotting business practices and conditions that can lead to contractor failure.

WHAT LEADS TO CONTRACTOR FAILURE

Contractor failure is usually the result of multiple causes. The Surety & Fidelity Association of America (SFAA) reviewed 86 claims cases and identified unrealistic growth, performance, character, accounting and management as the top five factors related to contractor failure.

Unrealistic Growth

- change in type of work performed
- expansion into a new geographic area
- significant increase in the size of individual projects
- rapid or over-expansion

Performance Issues

- inexperience with new scope or types of work
- personnel do not have adequate training or experience
- insufficient personnel

Character Issues

- contractor retires, dies, sells company, changes leadership or focus
- no ownership or management transition plan to ensure continuity in the event of death or disability

Accounting Issues

- inadequate cost and project-management systems
- estimating or procurement problems
- lack of adequate insurance
- improper accounting practices—not adhering to the AICPA(Audit Guide for Construction Contractors)

ABOUT the AUTHOR

This article was provided by Surety Information Office. For more information, please visit, www.sio.org or call 202.686.7463.

Management Issues

- key staff leaves company
- staff inadequately trained on company policy and operations
- insufficient or incapable personnel at upper management or project level
- failure to maintain solid accounting and management systems to track costs and billing

Other Factors

- economic down-turn and high inflation
- weather delays
- poor site conditions and/or building plans
- labor difficulties (lack of skilled labor)
- material and equipment shortages
- owner's inability to pay
- onerous contract terms

WARNING SIGNS THAT A CONTRACTOR IS IN TROUBLE

Ineffective Financial Management System

- inability to forecast cash flow or cash flow is tight
- receivables are turning over too slowly
- vendors are demanding cash on delivery for supplies and materials
- bills are past due
- profit fade

Bank Lines of Credit Constantly Borrowed to Their Limits

- all credit fully secured
- credit lines not being renewed

Poor Estimating and Job-cost Reporting

- revenue and margins decrease over time
- continued operating losses
- loss or reduction of bonding capacity
- bidding jobs too low

Poor Project-management

- inadequate supervision
- inability to administer and collect change orders
- project(s) not completed on time
- one or more contracts have a claim
- company is continually involved in litigation
- increase in backlog without adequate project-management resources
- lead time to prepare bids too short

No Comprehensive Business Plan

- contingency plans are not developed
- company does not have a "road map," goals or objectives

Communication Problems

- disputes between contractor and owner
- poor communication from field to management

It's a variety of successes that makes a good contractor, and it's a process that happens continually. Good contractors will heed the warning signs of failure before red flags go up. ♦

MODERN CONTRACTOR SOLUTIONS

Visit us now at moderncontractorsolutions.com

MODERN CONTRACTOR SOLUTIONS 1-866-251-1777

About Us | Contact | Advertising

THE EQUIPMENT & BUSINESS SOLUTION FOR CONCRETE & GENERAL CONTRACTORS

General Contractor Solutions
Concrete Contractor Solutions
Business Management Solutions
Local Weather

©2007 Highlands Publications, Inc. Survey • Terms and Conditions • Admin | enter | Get Local Weather

FTP Access

- Listen to insightful interviews from some of the construction industry leaders
- Find articles you may have missed, or need to review
- See the latest Trade Show and Events news
- Get your local weather here each morning to plan your jobsite

moderncontractorsolutions.com