

- shareholders' agreements detailing buy-sell agreement for multiple shareholders;
- only qualified and interested family members in management;
- detailed business plan; and
- strengths, weaknesses, opportunities, and threats

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 the red flags go up.

Surety Bonds: A Valuable Risk Mitigation Tool

Surety is a unique form of insurance in which the surety company's financial resources back the contractor's commitment to enter into a contract with an owner. Surety bonds are a three-party agreement among the owner (obligee), the contractor (principal), and the surety company, and the surety company is obligated to both the obligee and the principal.

Surety bonds provide financial security and construction assurance to project owners by verifying that in the surety's opinion the contractor is 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.

During the prequalification process, the surety:

- Verifies the contractor's ability to perform the contract and fulfill its financial obligations
- Completely reviews the contractor's financial statements, capacity to perform, organizational structure, management, trade references, credit history, and banking relationships
- Checks that there are no "red flags" that could lead to contractor failure

In the event of contractor failure, depending on the terms of the bond, the surety may:

- Re-bid the project for completion
- Bring in a replacement contractor
- Provide technical and/or financial support to the existing contractor
- Pay the penal sum of the bond

Construction is a risky business, and contractors fail for many reasons. Having a surety as a partner often helps a contractor prevent and avoid those risks. When a contractor does fail, however, having surety bonds in place ensures that the owner and the subcontractors on the project do not bear the full risk of that failure.

Surety Information Office (SIO)

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The Surety Information Office (SIO), formed in 1993, disseminates information about the benefits of contract and other forms of surety bonding in private and public construction. SIO, a virtual office, is supported by the National Association of Surety Bond Producers (NASBP), www.nasbp.org, and The Surety & Fidelity Association of America (SFAA), www.surety.org. For information on the benefits of surety bonds in construction and in other contexts, contact the Surety Information Office at sio@sio.org.



National Association of Surety Bond Producers (NASBP)

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The National Association of Surety Bond Producers (NASBP), founded in 1942, is the association of and resource for surety bond producers and allied professionals. NASBP producers specialize in providing surety bonds for construction contracts and other purposes to companies and individuals needing the assurance offered by surety bonds. NASBP producers engage in contract and commercial surety production throughout the U.S., Puerto Rico, Guam, and a number of countries. They have broad knowledge of the surety marketplace and the business strategies and underwriting differences among surety companies. As trusted advisors, professional surety bond producers act in many key roles to position their clients to meet the underwriting requirements for surety credit.

The Surety & Fidelity Association of America (SFAA)

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The Surety & Fidelity Association of America (SFAA) is a District of Columbia non-profit corporation whose members are engaged in the business of suretyship worldwide. Member companies collectively write the majority of surety and fidelity bonds in the United States. SFAA is licensed as a rating or advisory organization in all states, as well as in the District of Columbia and Puerto Rico, and it has been designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience. SFAA represents its member companies in matters of common interest before various federal, state, and local government agencies.

Why Do Contractors Fail?



Surety Bonds Provide Prevention and Protection

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Construction is a complicated business that faces ever-changing conditions, and those who are not prepared or capable of meeting these demands may ultimately fail. Every year thousands of contractors, whether in business for two or twenty years, face bankruptcy and business failure. According to BizMiner, of the 986,057 general contractors and operative builders, heavy construction contractors, and special trade contractors operating in 2011, only 735,160 still were in business in 2013—a 26.24% failure rate. These businesses leave behind unfinished private and public construction projects—and still worse, millions 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.



Events That Lead to Contractor Failure

Contractor failure usually is the result of multiple causes. Contractors may default if there are drastic financial changes due to the economy, unforeseen changes in job site conditions, or death or illness of a key employee. Other factors include: accounting issues; management issues; unrealistic growth—changes in type of work performed, expansion into a new geographic area, rapid over-expansion; and, performance issues—inadequately trained personnel or insufficient personnel.

Warning Signs That a Contractor Is in Trouble

Ineffective Financial Management System

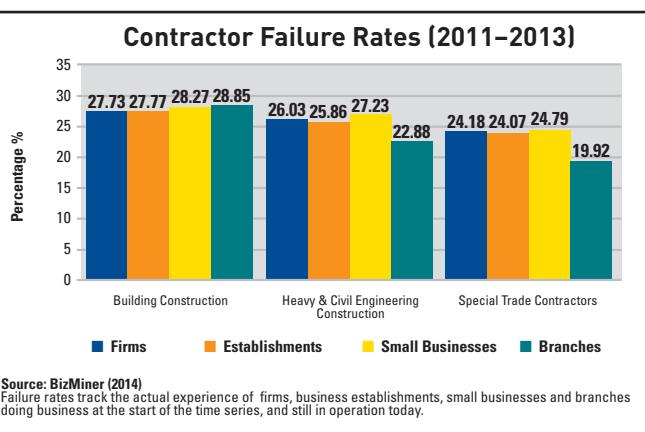
- Cash flow is tight or there is an inability to forecast cash flow.
- Receivables are turning over too slowly.
- Vendors demand cash on delivery for supplies and materials.
- Bills are past due.
- Company experiences profit fade.

Bank Lines of Credit Constantly Borrowed to Their Limit

- All credit is fully secured.
- Credit lines are not renewed.

Poor Estimating and/or Job Cost Reporting

- Revenues and margins decrease over time.
- There are continued operating losses.
- The company has a loss of or reduction in bonding capacity.
- Company bids jobs too low.

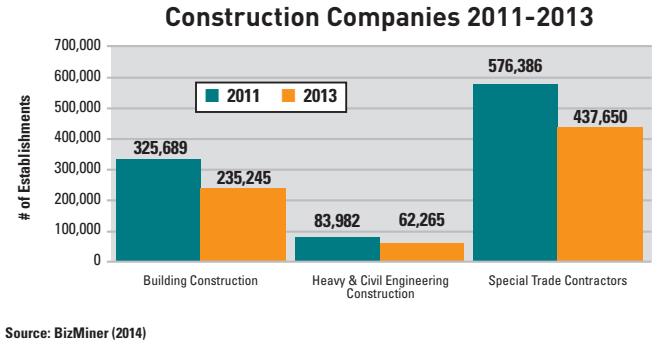


Poor Project Management

- Supervision is inadequate.
- There is an inability to administer and collect change orders.
- Projects are not completed on time.
- There is a claim on one or more contracts.
- Company is continually involved in litigation.
- Backlogs increase without adequate project management resources.
- Lead time to prepare bids is too short.

No Comprehensive Business Plan

- Contingency plans are not developed.
- Company does not have a “road map,” goals, or objectives.



Qualities of a Solid Contractor

According to FMI Corporation’s “What Makes a Good Contractor?” by Stuart M. Deibel, good contractors share these characteristics:

Organization

- Formal and on-the-job training for all levels of employees
- Logical, incentive-based compensation plan
- Tenure for proven field superintendents and internal promotion when possible
- Depth at all levels of the organization
- Succession planning
- Up-to-date, distributed organization chart
- Culture of loyalty, ownership, and urgency
- Visionary, inspirational leadership
- Low turnover

Finance

- Solid management of cash flow and overhead
- Profit-focused company
- Timely payment of bills
- Management of debt and retainage
- Reasonable growth without overextending resources

Marketing

- Superior estimating skills and systems to manage costs
- Satisfied customers
- Well-defined market niche and 12–36 month growth plan
- Company culture where everyone is a great salesperson

Project Control

- Closely managed projects with early warning systems to catch potential problems
- Litigation avoidance
- Productive field managers trained to improve processes

Planning

- Disaster preparedness
- Continuity plan with:
 - adequate life insurance coverage;