

AVOIDING THE BIG

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PREVENTING DEFAULT STARTS EARLY

**GREAT SURETY
PRODUCERS AND
UNDERWRITERS
MAKE
CONTRACTORS
STRONGER**

BY MARC RAMSEY

A

surety company does more than prequalify contractors. It also helps nurture and foster profitability and success.

For example, Pennsylvania National Mutual Casualty Insurance Co. recently had the opportunity to work with a construction company in business 23 years. However, Penn National's client made a couple of job mistakes that led to losses, and it was readily apparent from the financial statements the company was not following proper management practices. The company also didn't have a cost system detailed enough to show what was really going on.

After a frank conversation, Penn National resolved that if the contractor implemented certain recommendations—including bringing in a nationally known

construction consultant—the surety would provide a planned, step-by-step bonding program. Once certain improvements had been made, Penn National extended more bonding capacity until all of the identified problems were corrected and the contractor was back to making a solid profit.

"Difficult times can be the best thing that ever happens to a contractor—assuming it survives," says Michael Greer, vice president of surety, Penn National. "You have to be willing to take a hard look in the mirror and figure out where you went wrong and stop doing that. It is amazing the number of times companies make the same mistake over and over again.

"Not every owner has the stamina to have someone point out their blemishes,"

Greer adds. These types of scenarios require a considerable amount of time and effort on the part of both the agent and the surety. Given the extra time and cost involved, there has to be a very straightforward agreement of what will and won't be done."

“Contractors need to make a sufficient profit margin on their projects and should learn to say ‘no’ to jobs that don’t meet these margins.”

—TERRENCE CAVANAUGH, CHUBB SURETY

It's times like these that a good relationship with a surety bond producer and underwriter pays off—and it starts with communication. The most important thing a contractor can do is keep the surety informed when problems arise. This means communicating good and bad news to the surety bond producer and underwriter if or when problems begin. If possible, many sureties will work with the contractor to help it through the problem.

In addition to maintaining open communication, industry experts recommend contractors stay within their capabilities. In other words, think twice before working outside known geographical areas and scope of work.

Practical Tips

- 1] Don't take on more work than you can manage.
- 2] Grow your balance sheet in relation to your work program.
- 3] Keep your debt as low as possible.
- 4] Work to develop a strong relationship with your surety and provide full disclosure.
- 5] Understand the contract and make sure it defines default.

“Contractors are like any other business in that their ultimate success or failure is largely determined by the skill of management,” explains Doug Hinkle, chief underwriting officer, CNA Surety. “Low profit managers, high overhead and poor estimating are examples of symptoms that

generally point to a more fundamental problem within management.”

Contractors need to manage growth and control overhead. This includes maintaining accurate and current financial records and documenting change orders, disputes, claims and back charges.

“Construction is an amazingly complex business where many factors can drive success or failure,” says Dennis S. Perler, president, Liberty Mutual Surety. “Frequently, contractor difficulties stem from rapid growth, under-capitalization, inadequate liquidity, weak internal controls and poor project oversight.”

Contractors need to understand the contract—and risk variables such as financing, schedule and scope—and look for effective and equitable contract language that spells out the responsibilities of the owner, contractor and design professionals. Furthermore, the contract should define circumstances constituting default. Contractors should adhere to contract requirements, including scheduling, and comply with notice requirements.

If a project isn't right or the contract language is onerous, experts recommend declining the job. Adjust overhead instead of accepting a job merely to keep employees busy. “Contractors need to make a sufficient profit margin on their projects and should learn to say ‘no’ to jobs that don't meet these margins,” says Terrence Cavanaugh, chief operating officer, Chubb Surety.

Michael J. Cusack, senior vice presi-

Advice for Preventing Failure

- Use a construction-oriented accountant;
- Learn causes and warning signs of contractor failure;
- Have a bank line of credit available to support the company's business plan;
- Conserve capital;
- Bond subcontractors, especially when they represent a key trade, a significant portion or sole source of the work, or there are questions on their availability, capacity, ability or financial strength;
- Qualify the surety;
- Read and understand the bond forms;
- Understand the surety's rights and responsibilities toward the contractor and owner; and
- Qualify the owner. Is there sufficient financing? Beware of owners with a track record of litigation.

dent and managing director of surety, Aon Construction Services Group, agrees margin discipline and contract language are two issues that dictate the long-term success of many construction franchises. “These are fundamental issues in the industry and both are within the contractor's control,” he says. “Over the long term, the more successful contractors are generally the firms that demonstrate more discipline in applying appropriate margins to the risk profile of work and refuse to accept unreasonable and inequitable risk in construction contracts.”

Finally, developing and maintaining a lasting surety relationship is essential, especially in times of economic uncertainty. The contractor, professional surety bond producer and underwriter are the key players on this strategic business team.

Advises Greer: “People who don't know you are not going to support you when you need them most.”

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