Surety Information Office

WHITE PAPER

Top 4 Reasons Contractors Fail

Surety Information Office (SIO)
1828 L St. NW Suite 720
Washington, DC 20036
p 202.686.7463
f 202.686.3656
sio@sio.org
www.sio.org

A. CONTRACTOR FAILURE

Construction is a complicated business that faces ever-changing, ever-challenging conditions, and contractors who are not prepared or cannot meet these demands run the risk of failure. Thousands of contractors, whether they have been in business for two years, 20, or 100, fail each year, leaving behind unfinished private and public construction projects with billions of dollars in losses to project owners, construction lenders, and taxpayers.

TOP 4 CAUSES

Contractor failure is usually the result of multiple causes. The Top 4 reasons contractors fail include:

1. Financial Issues
    - Slow collections
    - Low profit margins
    - Insufficient capital/excessive debt
    - Bank line of credit used excessively
    - Estimating or procurement problems
    - Failure to maintain solid accounting and management systems to track costs and billing
    - Lack of adequate insurance
    - Improper accounting practices (not adhering to the AICPA Audit Guide for Construction Contractors)
2. Management Issues
    - No business, risk management, or continuity plans
    - Poor project management
    - Key staff leaves company
    - Staff inadequately trained on company policy and operations
    - Insufficient or incapable personnel at upper management or project level
    - Inadequate cost and project management systems
3. Unrealistic Growth/Overexpansion
    - Change in type of work performed
    - Expansion into a new geographic area
    - Significant increase in the size of individual projects
    - Unfamiliarity with architect, owner, or subcontractors

4. Uncontrollable/Other
    - 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 or cost increases
    - Unreasonable owner or owner's inability to pay
    - Onerous contract terms

FAILURE RATE

According to BizMiner, 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% failure rate.

COST OF FAILURE

So who pays when a contractor fails? If the contractor is not bonded, the taxpayer, owner, or lender does. For bonded contractors, these failures translate into losses for the surety industry. The Surety & Fidelity Association of America (SFAA) reports that sureties have paid nearly $10 billion on contract bond claims since 1995.

B. SOLUTION

SURETY BONDS

Construction project owners and lenders 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 and lenders by verifying that contractors are capable of performing the work and will pay certain subcontractors, laborers, and material suppliers.

Surety bonding is a three-party relationship among the owner, contractor, and surety. With a surety bond, the surety company and its financial resources stand behind the contractor, which enables the contractor to enter into a contract. The project owner receives a bond from a financially responsible corporate surety company licensed to transact surety.

TODAY'S MARKET

In today's robust nonresidential construction market, one of the biggest dangers to project owners and lenders is an overextended contractor. Mistakes can happen in the field when a construction company is stretched to its financial and organizational capacity and capability. While surety bonds are mandated by law of most public construction, private project owners can mitigate risk by requiring performance and payment bonds on their projects

The surety team ensures that bonded contractors have the talent within their organizations to handle all the work they have in their backlogs. That includes making sure the necessary subcontractors are available to complete the project.

Surety professionals create an active dialog with contractors to understand their business plan, appetite, and the means—both financial and resource capability—by which they will profitably avail themselves of the opportunities that exist in today's market.

C. EVALUATION

BENEFITS

Contract surety bonds provide direct protection to project owners as well as laborers, subcontractors, and suppliers. At the same time, they benefit construction lenders, architects, engineers, attorneys, risk managers, and contractors themselves.

For the project owner, performance and payment bonds give the security of knowing that the contractor has satisfied the surety's comprehensive prequalification review and will pay subcontractors and materials suppliers.

Surety bonds provide the construction lender with assurance that if the contractor is paid for the work, the project that secures the loan will be built in accordance with the terms of the contract.

Surety bonds provide the architect or engineer the confidence that, in the judgment of the surety, the contractor is capable of translating the plans into a finished product.

For the project owner's attorney, surety bonds provide the security of knowing that the owner will be protected if the contractor fails to perform.

Surety bonds also provide the risk manager with the satisfaction of knowing that the owner is protected against one of the major construction perils—contractor failure.

And, of course, surety bonds help contractors by screening out unqualified competition.

D. RESOURCES

SURETY INFORMATION OFFICE

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202.686.7463; 202.686.3656 fax; www.sio.org; sio@sio.org

The Surety Information Office (SIO) is the information source on contract surety bonds in public and private construction. SIO offers complimentary brochures and CDs and can provide speakers, write articles, and answer questions on contract surety bonds. SIO is supported by The Surety & Fidelity Association of America (SFAA) and the National Association of Surety Bond Producers (NASBP). All materials may be accessed at www.sio.org.

THE SURETY & FIDELITY ASSOCIATION OF AMERICA (SFAA)

1101 Connecticut Ave. NW, Suite 800, Washington, DC 20036
202.463.0600; 202.463.0606 fax; www.surety.org; information@surety.org

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.

NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS (NASBP)

1828 L St. NW, Suite 720, Washington, DC 20036-5104
202.686.3700; 202.686.3656 fax; www.nasbp.org; info@nasbp.org

NASBP is the international organization of professional surety bond producers and brokers. NASBP represents more than 5,000 personnel who specialize in surety bonding; provide performance and payment bonds for the construction industry; and issue other types of surety bonds, such as license and permit bonds, for guaranteeing performance. NASBP's mission is to strengthen professionalism, expertise, and innovation in surety and to advocate its use worldwide.