WHITE PAPER

6 Warning Signs A Contractor Is In Trouble
A. WARNING SIGNS

1 IN 5 CONTRACTORS FAIL

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. That equates to a 23.6% failure rate.

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

1. Ineffective Financial Management System
   - Inability to forecast cash flow or cash flow is tight
   - Receivables turn over too slowly
   - Vendors demand cash on delivery for supplies and materials
   - Bills are past due
   - Profit fade or low profit margins

2. Bank Lines of Credit Constantly Borrowed to Their Limits
   - All credit fully secured
   - Credit lines not being renewed
   - Insufficient capital, excessive debt

3. Poor Estimating and/or Job Cost Reporting
   - Revenue and margins decrease over time
   - Continued operating losses
   - Loss or reduction of bonding capacity
   - Bidding jobs too low

4. 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

*Contractor Failure Rates* (2004-06)

[Graph showing contractor failure rates]

Source: BizMiner 2006

*Percentages of non-single family building, heavy/highway, industrial buildings/warehouses, hotel/motel & multifamily home construction, trade contractors, and specialty trade contractors that were no longer in business in 2006.
• Incompetent or poorly trained personnel
• Failure to manage or consider risks
• Change in ownership or key personnel

5. No Comprehensive Business Plan
• Contingency plans are not developed
• Company does not have a “road map,” goals, or objectives
• Overexpansion – geographic, size or type of project

6. Communication Problems
• Disputes between contractor and owner
• Poor communication from field to management

B. SOLUTION

PREQUALIFICATION
Surety companies conduct a careful, professional, and rigorous prequalification review of the contractor. The in-depth prequalification process includes a complete review of financial statements, capacity to perform, organizational structure, management, trade references, credit history, and banking relationships. Before a surety issues the performance and payment bonds, it must be satisfied that the contractor runs a well-managed, profitable enterprise, deals fairly, and performs obligations as agreed.

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).

SPECIFY SURETY BONDS
Preventing contractor default is the surety’s objective. Surety underwriters and surety bond producers are experts at assessing the strength of a construction firm based on a prediction of profits on uncompleted jobs and the analysis of the contractor’s cost systems, billing patterns, timeliness of completion, and likelihood of profitability.

Requiring performance and payments bonds on a project lessens the likelihood of contractor failure. Should the contractor default despite the rigorous underwriting, the surety company is there with 100% performance and 100% payment bonds to bring the project toward completion.
C. RESOURCES

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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.

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