



WHITE PAPER

6 Warning Signs A Contractor Is In Trouble

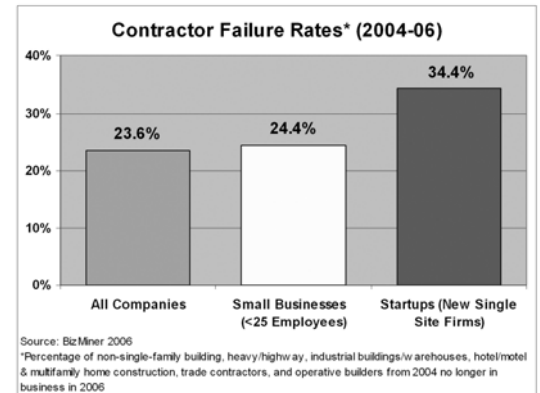
Surety Information Office (SIO)
1828 L St. NW Suite 720
Washington, DC 20036
p 202.686.7463
f 202.686.3656
sio@sio.org
www.sio.org

A. 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

- 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

SURETY INFORMATION OFFICE

1828 L St. NW, Suite 720, Washington, DC 20036-5104

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.