Biggest Risks for Contractors in Today's Market

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According to numerous studies performed by sureties and other construction industry consultants, more contractors fail during the recovery following a recession than on the way into one. What may be even more surprising is that many of the risk factors that contribute to contractor failure are present in the market today.

Tight margins, increasing volume

According to research done by Travelers, the nation's largest surety, revenues of their clients have increased by almost 50 percent since the lows of 2010, yet the margins, on average, have risen less than 10 percent. For many trades, especially those in public works, margins are still thin enough that one mistake can lead to losses on a job.

As every contractor knows, it only takes one or two bad jobs to ruin an otherwise good year, and as more projects are taken on, it becomes harder to manage them with the same consistency. As a result, contractors should remain diligent and be very selective in the work they take on.

Skilled labor shortage

Lack of skilled labor has been a problem for several years now, especially in the private sector, and we are hearing more and more of our clients that perform public works raise it as an issue. In fact, in the 2016 AGC/FMI Risk Management Survey skilled labor was the number one risk contractors cited.

In the United States, more than 10,000 baby boomers retire each day and are being replaced by much less experienced millennials. For many long-established contractors, this means losing their 20 or 30-year key employees like chief estimators, superintendents, and foreman to retirement. Proactive planning to hire and train replacements is critical.

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Maintaining high standards for employees and avoiding the temptation to overlook obvious problems, even if it means missing out on good projects, will be critical during this period of growth.

Loosening surety credit

The good news for contractors is there are plenty of sureties in the market offering bonding capacity. The bad news is the surety market is getting a little too competitive.

Why is this bad you ask? In his book, Manics, Panics and Crashes, Charles Kindleberger says bubbles are first created when opportunities (such as more construction work) combine with loosening credit (like easing surety standards) to create a kind of euphoria in the market. Think back to 2006 when people with very little income were getting loans for million-dollar homes purchased with no money down.

If the surety industry continues to loosen as work increases, the same thing could happen. Sureties will dial back their underwriting standards and questions, which is a huge part of their role – using best practices accumulated through years of experience to prequalify contractors.

Loosening standards could mean a competitor with a poorly run business and/or bad reputation could be able to bond as much as you can, and sureties could begin to sign-off on contractors chasing risky work.

Even though having to answer underwriting questions from a surety can be inconvenient, it is more important than ever that contractors work with agents and surety underwriters that they respect for their industry knowledge and that will be honest about the risks they see in a contractor's strategy. Allowing for an open dialogue can serve as a way for contractors to critically examine their plans and avoid operating in a vacuum.

Two separate studies on contractor failure performed by construction consultant Dr. Thomas Schleifer and FMI conclude the number one reason for contractor failure is poor management decisions. The good news is contractors that remain disciplined in their approach to business should have an excellent opportunity for growth and success during the next few years.