MAXIMIZING YOUR SURETY CREDIT

Contracting is an extremely risky business. Indeed the average life expectancy of a construction company is only about 7 years, yet many firms last much longer. Interestingly, there seem to be certain common characteristics exhibited by the most successful of these firms. Many of these traits also happen to be the key areas that surety underwriters focus on, and if put into practice by a contractor, should result in greater surety credit being made available. In fact, these tips might just help you in building a more successful business over the long term.

Having spent the past 20 years focused on the construction industry, working with contractors and their brokers as a surety underwriter, I have developed a deep and lasting respect for contractors – pure entrepreneurs who risk everything by committing to get a job done for a specific price. My job is to evaluate and assess construction and business risk, and ultimately to decide whether to put my company's assets on the line in support of a contractor on a particular project or on his entire work program.

Sureties evaluate the three C's of credit in their assessment of a contractor – character (integrity), capacity (ability to do the work, track record) and capital (working capital, net worth, cash). In short, a contractor must inspire a fourth C in the underwriter – Confidence. If my confidence level in the abilities of a contractor is high, I am going to support the contractor to the maximum amount I can. In my experience, here are some of the things that I look for:

Planning

The most successful contractors plan for their success. They budget and forecast revenues, expenses and cash flow and compare these projections to actual numbers. They develop annual and often longer term business plans and execute them effectively. They plan for the future by establishing well thought out succession plans. In short, they keep surprises to a minimum. Planning effectively, and sharing your organizations direction with your surety underwriter, is a big plus.

Stick to Your Knitting

Focus on work you know your organization can handle. Variables to consider include scope of work, resource allocation, size of jobs and geographic location. The best contractors demonstrate discipline and self control in the work they pursue and will not "bet the company" on any one job. A great contractor once told me sometimes the best job is the one you do not bid.

Build Net Worth and Working Capital

We look for our contractors to make money and keep profit (at least some) in the company. I know this sounds rather obvious, but the most successful contractors are those that have built a strong foundation by adding to their financial resources year in and year out. Working capital, the liquidity or net cash resources of a firm, is a true sign of strength and demonstrates a contractor's ability to deal with the inevitable short term hiccups involved in the business. Most sureties will simply calculate net worth and working capital and apply a leverage factor to determine the maximum support in terms of bonded and un-bonded aggregate costs to complete they will grant a contractor. A basic rule of thumb is the higher your working capital, the more surety support you will get.

Avoid the Bank

With few exceptions, General Contractors should have net cash balances and not borrow (except to finance fixed assets). Sureties tend to have a negative view to Generals that borrow regularly to either finance day to day operations or work in progress, and these companies will generally not get the same surety support as companies that run with cash balances. Subs, by their nature, tend to be borrowers as they have to finance labour and materials. For both, it is important to have an operating line of credit available to you that can act as a buffer if cash flow gets tight, and make sure you set it up when times are good (ok, this may now be too late!). Remember that the banks will give you an umbrella only when the sun is shining, and depending on the timing of the economic cycle and management's flavour of the month are either in construction or out of it. Don't allow the bank to take cash resources to secure the operating line of credit as this simply defeats the purpose of getting it in the first place.

The bottom line is that if you rely heavily on the bank you have given up some of the control and flexibility of your organization. Speaking of bottom lines, the contractor earning interest income because he has cash has a competitive advantage over the contractor paying out interest expense because he borrows.

If possible, use fixed assets such as land and buildings and equipment to borrow a longer term to help create working capital.

Keep Your Company "Clean and Simple"

Complex and confusing organizations with different year ends and numerous inter-company transactions do not inspire confidence in your underwriter (and they are far more work for us to understand). Clean and straightforward organizations get the most support. If you are going to invest in opportunities outside of your construction business, keep them separate from and without compromising your bread and butter contracting business.

Practice Prudent Risk Management

Reduce and spread your risk by signing good contracts, ensure the company you are working for can and will pay you, bond back your own sub-trades and major suppliers. Take as much risk out of your jobs as you can and protect your margin.

We are seeing an ever increasing pass through of risk down from owners and their consultants to contractors, and prudent risk management control is a must. Ensure your business is adequately insured, including key man life and critical illness insurance payable to your business in the event of your untimely demise or illness.

Keep Disputes and Litigation to a Minimum

Litigation is expensive and with uncertain outcomes the only sure winners tend to be the lawyers. Construction is all about disputes and excellence in dispute resolution is a differentiating factor for the best contractors. Sureties do not like to issue lien bonds and hate getting dragged into disputes. As an underwriter, I have the highest confidence in organizations that deal with their problems quickly and quietly.

Build the Best Team of Professionals You Can

Surround yourself with experts in all facets of your business. This includes your surety and insurance broker, your accountant, lawyer, banker and underwriter. I find that the best contractors draw on these resources almost like an external board of directors and use the advice of truly knowledgeable people in helping shape and direct their business. There are very few experts in each of these areas in each region of Canada, so make sure you get the best you possibly can and use them whenever possible.

Provide Quality Information

Regular information flow to your underwriter allows him or her to know what's going on in your organization. Most sureties look to receive accurate and timely quarterly updates of financial statements, work on hand reports, listings of accounts receivable and payable from their active accounts. Advance notice of large upcoming tenders is also a plus. The better the information flow to your surety the more comfort they will have with your program and the more support you will get. Sureties generally require annual financial statements to be prepared on a review engagement or audited basis. Notice to reader statements generally are not acceptable.

Get to Know Your Surety Underwriter

Insist on getting to know your surety underwriter, and especially the decision makers within the surety company. Our comfort with a contractor tends to increase with familiarity and if we can get together face to face from time to time it will help you maximize your support.

Hopefully, some of these tips will help you understand more about how a surety underwriter approaches your business and will enable you to maximize your surety support. More importantly, I hope they will help you grow and manage your business even more successfully in the future.

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