

The Risk of Contractor Default

Synopsis

One of the most important risks in the construction process is the risk of contractor default. It is in the interest of contractors to understand failure patterns, to have a good idea of the reasons why construction companies fail, and to be able to predict company decline and prevent failure. It is in the interest of construction owners to identify contractors that are likely to default, and to protect themselves against contractor default. A research program that extended over a thirteen-year period (1995-2008) attempted to address these issues and resulted in a multitude of findings that are summarized in this paper. The program found that company failure is age and size dependent. It also found that most causes of failure can be prevented by short-term management action and that causes of failure are less dependent on long-term external factors on which the management has no control. It was also found that it is possible for the executives of a company to predict decline by using non-financial data and to take corrective and timely action to create the environment for a turnaround. The owner, on the other hand, can use the traditional bonding/insurance tools and transfer most of the risk to third parties, or can implement a performance assessment model to identify troublesome companies, and a risk management model to protect the company against contractor default by retaining some of the risk whenever appropriate. Both models were developed as part of the said research program.