



# Construction Insights

North America Construction | Risk Engineering

## Warning signs of subcontractor distress

Although there may be cases when a subcontractor default is a complete surprise, there are almost always warning signs. Your teams should be aware of these signs and make every effort to identify them – EARLY, while there is a better chance to manage it. So what should they be watching for?

### What did your Prequalification and Purchasing Process tell you?

Your prequalification and purchasing process may have showed you a thing or two to watch for with your intended subcontractors. Warning signs may be identified for specific areas such as financial, capacity, geography or market experience, bid spread, labor, and many others. This early time period is a Builder's best (least expensive, most effective) chance to address these risks – by avoidance or management.

All things considered, it may still be your best option to award to a “less than perfect” subcontractor. If this is the case, ensure that:

- Identified risks are clearly communicated to and understood by all relevant team members – ensuring they understand why they are being asked for additional diligence
- Identify a specific and effective risk mitigation plan (RMP) with clear responsibilities
- Plan to monitor implementation – not only ensuring the identified RMP is being implemented, but paying attention to what it is telling you – are there further signs of subcontractor distress?

### What is happening during the course of the project?

Evaluation of a subcontractor's strength prior to award is a snapshot in time. Over the course of a project, a subcontractor may be impacted by factors outside of your control. It is important for project teams to be on the lookout for early warning signs for all subs, which are **typically evident in three core areas: project management, field management and payment concerns.**

## 1 Project management

- Long turnaround, incorrect, or incomplete response to basic/important project needs:
  - Subcontract execution, submittals, shop drawings, insurances, etc.
  - Pre-operational planning meetings
  - Schedule integration
  - Missed deadlines/empty promises
  - Poor internal communication – Unfamiliarity or inadequate understanding of the project
  - Are the above signs that complexity of scope/project is beyond norm or capabilities?
- Inconsistent focus on your project due to “fires” on other project or staff turnover?
  - Difficulty communicating with sub: missing meetings, avoiding phone calls, etc.
  - Lack of follow-through on agreements: management changes, schedule variations
- Evidence that the project manager does not have adequate resources
  - Are field staff made available to attend key preparatory meetings?
  - Are staff committed to ensuring early project needs are addressed?
  - Missed schedule dates

## 2 Field management

- Lacking full engagement in preparatory activities
  - Planned field supervision not engaged in preparatory activities: mockups, kickoff, etc.
  - Field supervision does not fully understand their scope, production requirements, schedule, quality requirements, safety, etc.
  - Field supervision does not have control over crew size/staffing, equipment, etc. necessary to meet project quality, schedule, and safety needs.
  - No agreement on “the startup plan”
- Unproductive startup of operation(s):
  - Not following “agreed” plan: labor, materials, schedule, etc.
  - Insufficient or inadequately trained work force
  - Using incorrect contract docs; not following approved submittals/shop drawings
- Ongoing operations
  - Turnover of field supervision or craft labor or insufficient labor
  - Impacts from other projects affecting manpower or “promised” supervisors/craft
  - Difficulty projecting schedule and/or achieving productivity goals
  - Quality control issues and rework
  - Reactive (fighting fires) vs proactive (plan ahead, coordinate with others, etc.)
  - Missed deadlines/empty promises
  - Inadequate or poorly maintained equipment
- What is the “rumor mill” saying?
  - External – Industry contacts, sub work force
  - Internal – Accounting department, field staff, etc.

## 3 Payment Concerns

- Pay Requisitions:
  - Submitted late, incomplete, and without sufficient supporting documents
  - Consistent attempts to overbill or include unresolved change orders or claims
  - Expedited payment requests, offer of discounts for expedited payments, evidence of factoring (selling of account receivables at a discount), etc.
- Signs that sub is having issues making payments:
  - Notices from lower tiers or On-site labor re. not paid timely
  - Suppliers requiring payment upon delivery or requesting joint checks
  - Material deliveries “held hostage” pending receipt of accounts payable
  - Difficulties, inaccuracies, or delays in receiving lower tier lien releases

### Conclusion

All of this may sound like “a day in the life of a Construction Manager”, and it typically is. Any of these issues, on its own, may be considered “part of construction” and not necessarily indicative of subcontractor distress that will result in default. But, when multiple, excessive, or significant issues are evident, pay attention and engage a positive course of action that nips the problems in the bud – early, swiftly, and effectively.

**Please direct any questions regarding this or related industry matters to your AXA XL SDI Risk Engineer.**

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