The DNA of Construction Failure

Operational Warning Signs That Appear Years Before Financial Distress

Jeff Sawyer
Simplar Sourcing Solutions

Background

Grew up in the construction industry

Geotechnical investigations, materials testing & construction special inspector

Capital Projects Engineer – City of Prescott, AZ

Founded a design-build infrastructure contractor

Construction research – Arizona State University

Simplar Sourcing Solutions – contractor risk & project delivery advisory

Foundations of This Work

Dr. Thomas C. Schleifer, PhD

Construction executive, researcher, and industry advisor

Founded the largest consulting firm working with sureties on contractor failures

Author of multiple books on construction risk and financial distress

Advisor on hundreds of contractor defaults and turnarounds

Key insight: *The decisions that lead to contractor failure typically occur 1–3 years before the financial statements show distress.*

Construction Is a High-Risk Industry

~50%
Gone by
Year 5

~80%
Gone by
Year 20

1M+
Construction firms
in the U.S.

3-6% Average net profit margin

1–3 yr Lag between management decisions and visible financial distress

Half of all construction firms don't survive five years.
The ones that do still operate on razor-thin margins.

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Why Small Mistakes Are Lethal

A typical $10 million project

Revenue: $10,000,000

Costs: $9,700,000

Profit: $300,000 (3%)

> **If costs are off by just 3% … the entire profit disappears.**

In construction, small timing delays, missed invoices, and optimistic estimates routinely create errors this size.

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An Honest Industry

A Contractor's Training

Year 1: Foundations & Site Work

Year 2: Framing & Structural

Year 3: Mechanical & Finishing

Year 4: Running crews

Year 5: Winning bids

Masters of their craft.

A Business Student's Training

Year 1: Economics & Statistics

Year 2: Accounting & Finance

Year 3: Management & Strategy

Year 4: Organizational leadership

Year 5: Risk management

Masters of the business side.

They aren't lying to you. They are lying to themselves – because they believe their own flawed data.

Correct vs. Accurate

Construction financial statements are often mathematically correct…

but operationally inaccurate.

CORRECT

The math adds up.

GAAP-compliant.

Auditor-approved.

≠

ACCURATE

Reflects real-time

operational reality.

What's actually happening.

The math is correct. The timing is wrong.

The A/P Rule

A common example:

MARCH	APRIL	MAY – JUNE
Sub works 3 weeks	Sub works 2 more weeks	No invoice yet. Books show $0 for this work.

> Accounts Payable is either **correct** or **understated.**

Never overstated. Because invoices always arrive after the work happens.

The A/R Rule

Percentage-of-complete accounting:

What they report:

500 feet of pipe in the ground.

Two PMs walk the site.

They say the job is 60% complete.

60%

But is it?

Pressure tested?

Flushed?

Backfilled?

Inspected?

Or just pipe sitting in a trench?

Accounts Receivable is either **correct** or **overstated.**

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The Friday Problem

FRIDAY

Month ends.

Office closes the books.

Payroll cutoff was Wednesday.

THE FIELD

Still working.

Labor continues.
Materials delivered.
Sub invoices arrive weeks later.

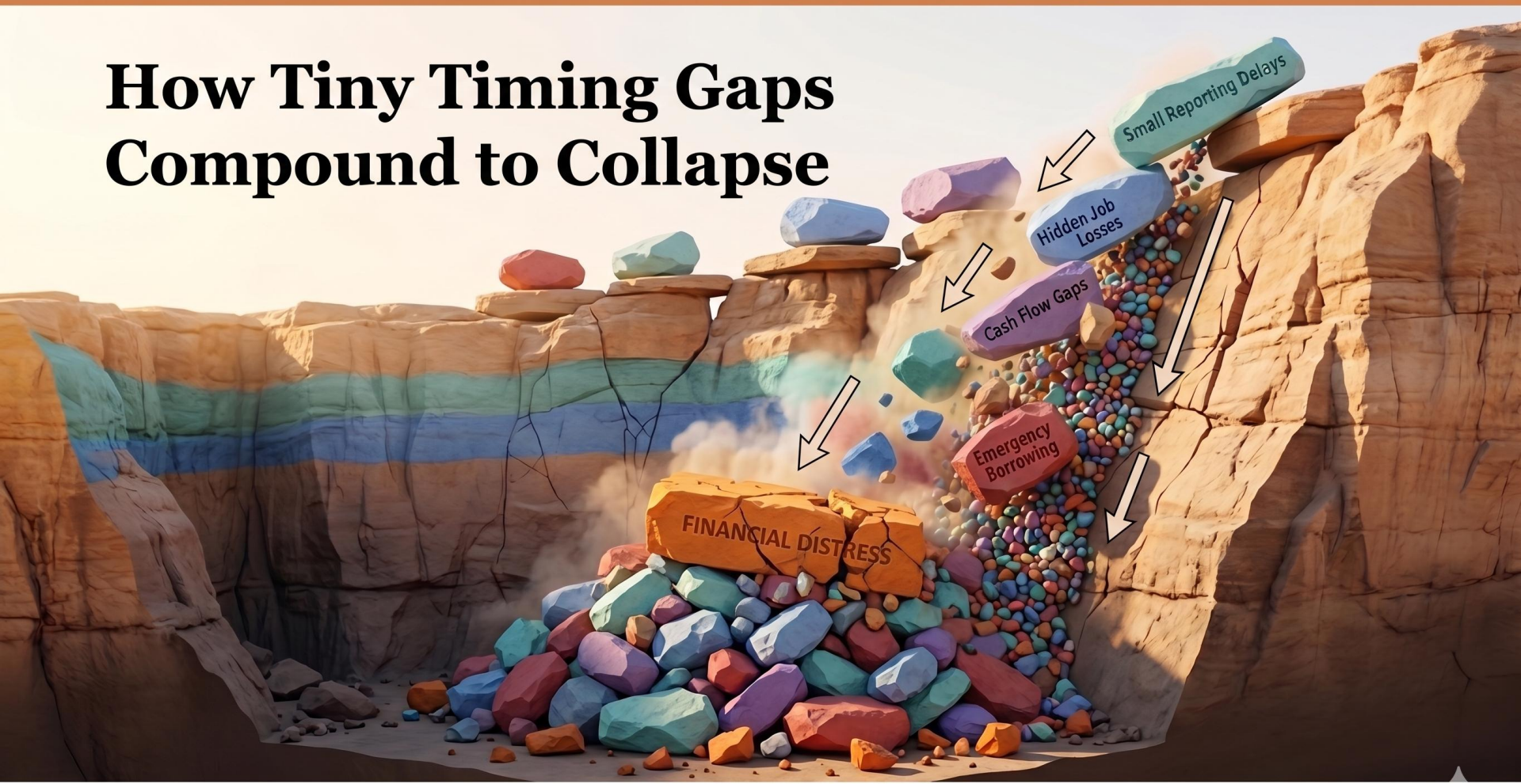
THE RESULT

2 days of labor not recorded.

That's 10% of the month's costs missing.

The financial statement is correct. But it isn't accurate.

How Tiny Timing Gaps Compound to Collapse



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Construction accounting doesn't fail because the math is wrong. It fails because timing gaps compound.

So where do failures actually begin?

Not in the financial statement.

In management decisions.

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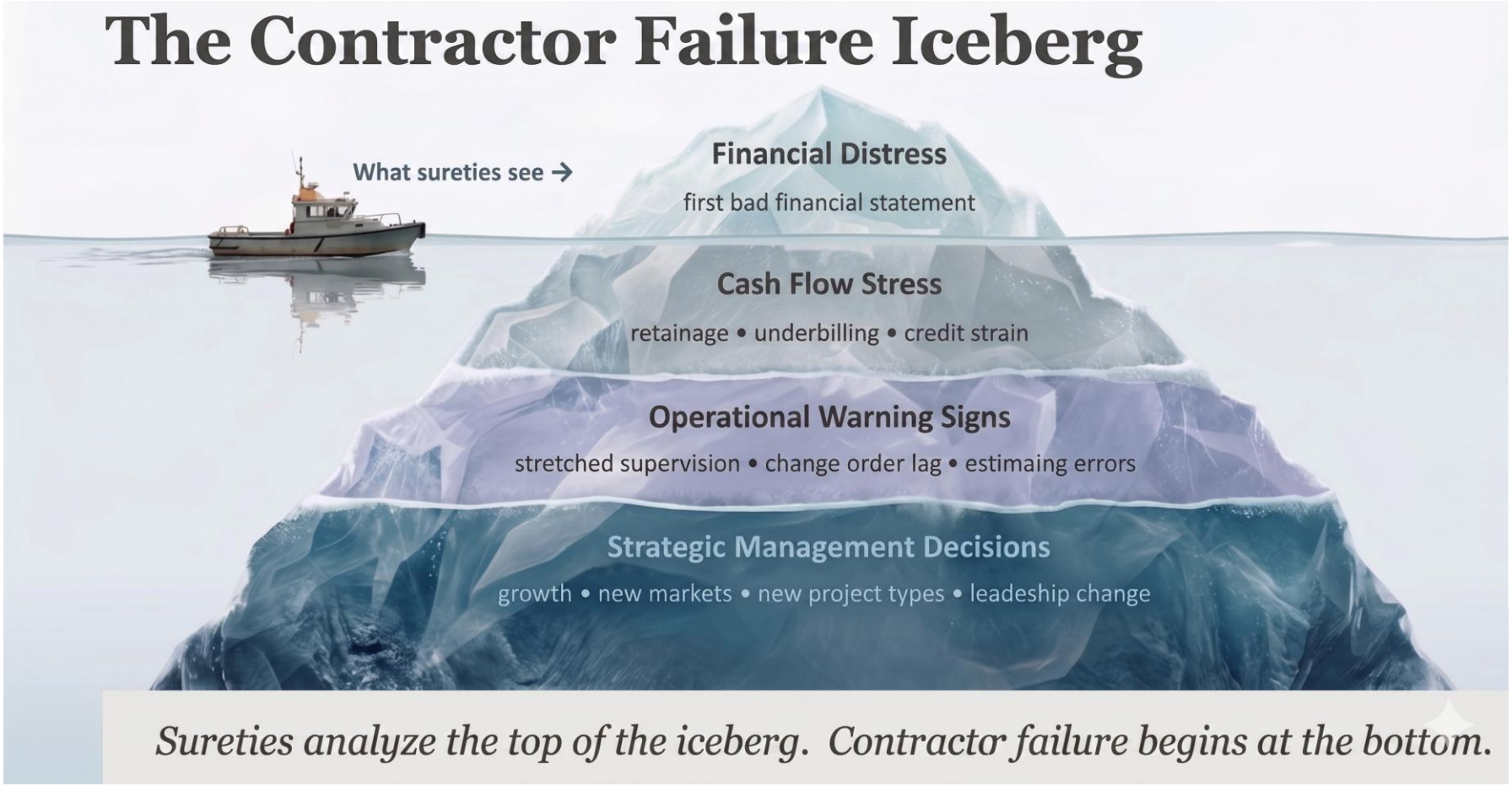
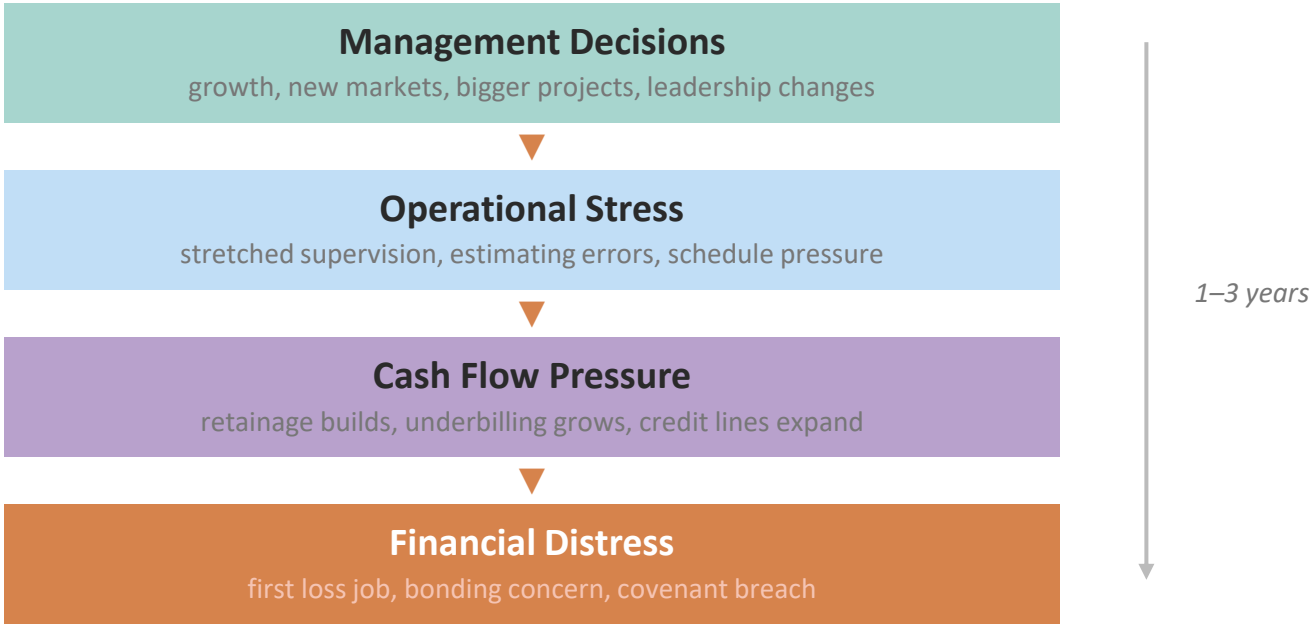
The Contractor Failure Iceberg



Sureties analyze the top of the iceberg. Contractor failure begins at the bottom.

The Failure Timeline



If you remember one thing today — remember this timeline.

The Five Failure Signals

Based on Dr. Schleifer's research on hundreds of contractor failures

1. Significant increase in project size
2. Expansion into new geographic markets
3. New or unfamiliar construction type
4. Loss or change of key personnel
5. Lack of managerial maturity

These signals typically appear 12–36 months before financial distress.

Signal #1

Scaling Risk

$1M

Years of successful projects
Good reputation. Solid crews.
Reliable suppliers.

→

$3M

Biggest project ever.
They finished it. Building stood.
But the company didn’t survive.

The supervision structure that worked at $1M didn’t scale to $3M.

Different: Architects – Inspectors - Red Tape – Etc.

A $3M project is not three $1M projects.

Signal #2

Geographic Drift

Expanding into unfamiliar markets introduces hidden risk.

Unknown Labor Rules

Union environments, prevailing wage, local hiring

Unfamiliar Suppliers

New subcontractor pools, unknown reliability

Different Regulations

Permitting culture, inspection requirements

Local Politics

Relationships, approval processes, community dynamics

The project may look the same on paper…
but the operating environment is completely different.

Signal #3

Capability Drift

Moving into unfamiliar construction types without organizational experience.

Roads, Grading & Concrete	→	**Wastewater plants**
Low-rise Commercial	→	**Hospitals**
Public Infrastructure	→	**Private Development**
Horizontal Work	→	**Vertical Construction**

Many contractors lose money on the learning curve before they ever gain competence.

Signal #4

Organizational Breaks

Every construction company depends on three critical functions.

Estimating & Sales

Winning work at the right price

Construction Operations

Building it on time and on budget

Accounting & Administration

Tracking money and managing risk

If one of these breaks — the company is fundamentally changed.

The Contractor Maturity Curve

When growth outpaces management maturity, the gap becomes the risk.

Signal #5

Managerial Maturity

The 5-Story Jail

Floor 5	Massive Loss
Floor 4	Losing Money
Floor 3	Over Budget
Floor 2	Slightly Over
Floor 1	"On Budget"

What happened:

The office averaged block costs across all five floors.

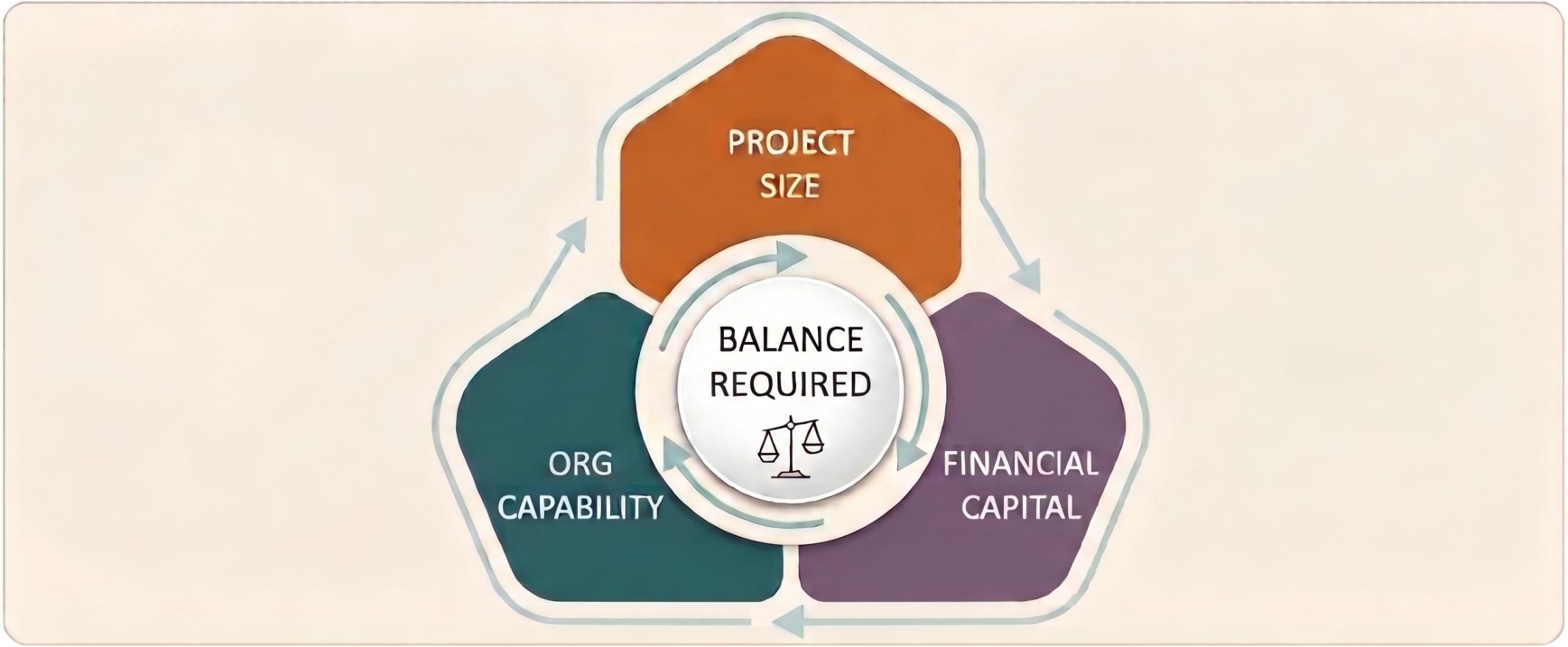
The field knew there was a problem in the first week.

Nothing was done for months.

By floor five, it was too late.

The company outgrew its leadership systems. Averaging hid the failure.

Balancing Growth, Capability, and Capital



Contractor stability requires all three forces to stay in balance.

From Autopsy to Early Detection

The Surety Opportunity

Traditional role

Study contractor failure after the loss

Opportunity

Identify operational signals before failure

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Five Questions Every Surety Should Ask

1. What is the largest single project you have ever completed?
2. What changed organizationally when you grew?
3. How many current projects are outside your normal market?
4. What key personnel have changed recently?
5. What systems changed as you scaled?

> *These questions go beyond the financial statement. They test operational health.*

Sharing What the Industry Learns

> *One of the challenges in construction is that business lessons aren't shared very well. Contractors share stories about projects… but rarely about business mistakes.*

Simplar Foundation Construction Research Blog

simplarfoundation.org

Weekly articles on contractor risk, project selection, leadership, and business management for the construction industry.

Read it. Share it widely.

Helping Contractors Avoid Preventable Failure

My team works with contractors and project owners to:

Identify operational risk early
Corporate analysis and organizational assessments

Improve project selection
Right projects for the right organization at the right time

Strengthen leadership systems
Leadership coaching and management development

Optimize project delivery
Alternative delivery methods: PDB, DB, CMAR

If you're working with contractors who are growing quickly or facing operational stress, our team can help.

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The Autopsy vs. The Diagnosis

Sureties often study the autopsy of contractor failures.

The real opportunity is recognizing the symptoms while the patient is still alive.

Most contractor failures are not caused by dishonest people.
They are caused by good builders who never learned the business signals that trouble was coming.

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Questions & Discussion

Jeff Sawyer
jeff@simplar.com

simplar.com | simplarfoundation.org

Backup: Construction Contractor Failure Rates

Extended lifecycle view – U.S. modeled from BLS and industry data

Business Age	Cumulative Failure Rate	Failure Within Period	Survival Remaining	Interpretation
0–5 Years	**~45–50%**	~45–50%	~50–55%	Early-stage volatility: bidding errors, cash flow, backlog swings
6–10 Years	**~60–65%**	+10–15%	~35–40%	Stabilization phase; weaker firms shake out
11–20 Years	**~80–83%**	+15–20%	~17–20%	Growth risk dominates; overexpansion, complexity
21–30 Years	**~88–90%**	+7–10%	~10–12%	Mature firms; failures tied to succession + market shifts
31–50 Years	**~93–95%**	+5%	~5–7%	Very few persist; typically specialized or conservative
51–75 Years	**~96–98%**	+2–3%	~2–4%	Legacy firms; survival driven by governance + adaptation

Sources: U.S. Bureau of Labor Statistics – Business Employment Dynamics (bls.gov/bdm); U.S. Small Business Administration – Office of Advocacy; ConstructConnect (2022); FMI Corp – "Why Large Contractors Fail"