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Insurance Issues That Can Contribute to Contractor Failure

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Over the past 40 years there have been many ups and downs in the construction market. Unfortunately, it has become commonplace to see contractors repeating past mistakes, which can result in negative impacts on insurance costs.

Less than a decade ago, the United States went through the "Great Recession," and many contractors did not survive the downturn. The economy has been healthier over the past few years, but today economists are starting to see history repeat itself and contractors are once again at risk.

Most of the issues that are emerging stem from poor hiring decisions. These poor hiring decisions eventually lead to insurance problems, which then hit contractors hard when they need it the least: when the industry is facing a down market.

Based on historical trends, here is how the process works:

First, the economy is up and there is plenty of work available. While this may seem like a good thing, it can lead to increased competition and the hiring of unqualified workers. Since there are plenty of jobs available for everybody, the majority of contractors are looking for workers. Because of the strong demand for workers, hiring standards are often sacrificed in order to fill the positions.

Contractors begin hiring employees who may be inexperienced, have a poor work ethic, have marginal driving records, are physically incapable of doing the work or even have current or past issues with substance abuse. As a result of lower hiring standards, contractors can end up hiring workers who produce the following negative results:

- poor workmanship, which can lead to General Liability claims, hazards to co-workers and reputation damage;

- auto accidents, which can lead to bodily injury to others and expensive damage to company vehicles; and
- increased Workers Compensation claims, which lead to wasted time and inefficiencies in getting the jobs completed.

As with all business cycles, the economy will eventually start to slow - typically a few years later. As a result of the downturn, there is not as much work available and not as much need for employees. So who is the first to go? The employees who caused all of the problems, of course. But the legacy of those problem employees remains for the contractor, who must manage these potential outcomes:

1. General Liability insurance rates and deductibles increase. Insurance underwriters are less likely to provide quotations because of past lack of profitability, and they know they will likely pay even more completed operations claims in the future due to past poor workmanship;
2. Auto rates increase along with comprehensive and collision deductibles. Insurance underwriters are concerned that a contractor who put marginal drivers behind the wheel is probably likely to do it again when the economy improves. If an underwriter has been burned in the past, he is wary to make the same decisions again;
3. Workers Compensation Experience Modification increases due to past claims, with costs increasing accordingly. This can further compound problems because having the higher experience modification can prevent contractors from being awarded work since more and more companies use this as a pre-qualification;
4. Insurance audits come in from the prior year when work was up and the payroll was higher. As a result of the elevated numbers, the insurance company is looking for more money based on the previously higher payroll; and
5. Employment Practices Liability claims increase as employees who were let go may file claims of wrongful termination, discrimination or harassment. Many contractors do not even carry this coverage, opening them up to increased scrutiny and potential financial damage. Even if a contractor does carry the insurance, it becomes more likely he will face large deductibles.

These are just a few examples of how current business decisions can lead to future insurance pains at the worst possible time. Therefore, it is important for contractors to maintain their hiring standards, regardless of the economy's state, or they could be paying the consequences in the future.

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