



# **Causes of Contractors' Failure in Saudi Arabia**

CEM 520

Construction Contracting

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## **1. Abstract**

This report discusses the main causes of failure in the Construction industry in Saudi Arabia. A survey of 68 contractors from the entire Kingdom was undertaken. These contractors were classified by the Ministry of Housing and Public Works from grade one to four. The distribution of these contractors are as follows: 7 from grade one, 12 from grade two, 27 from group two, and 22 from group three.

The survey included 34 different causes of failure and their degree of importance. The severity factors of these causes were measured by their level of importance and were ranked according to the severity index for group one together, group two, and group three, and a combination of all respondents

It was concluded that lack of experience in the line of the work, neglect, poor estimation practices, bad decisions in regulating company's policy, and national slump in the economy are the most severe factors. Also, it was noted that grade three contractors give the most response, followed by grade four and then grade one and two. This reflects the true awareness of causes of failures among contractors.

## **2. Introduction**

The construction business has very high risks. These risks, which could lead to failure, come from the sensitivity of the business to economic cycles, and from high levels of competition. Because there are large numbers of contractors, it's easy to establish a new firm. Since the entry into the construction business is easy, implementation could easily be poor and unorganized, which increase the probability of a contractor's failure.

In construction, there are three parties involved, namely, owner, consultant and contractor. The relationship between these parties is adversarial because each party has goals which conflicts with the other parties' goals. The relation among the parties could be a major source of a contractor's failure.

There is no exact definition of a contractor's failure, however, it could be defined as when a business:

1. Cases operation following assignments due to the inability to continue construction.
2. Goes into bankruptcy due to failure of collecting money from customers
3. Voluntarily withdraws because of dissatisfaction with business or profit.

The construction industry attracts many people because of their belief if high profit, but when they enter the business, they will feel the difficulty and complexity of it.

### **3. Previous Studies**

Business failure in construction doesn't have much written about it. It has been stated like "unlike the study of how to succeed in business, the study of business failure has not been given attention" (Kungari, 1988).

Dun and Bradstreet Corp. is a private corporation that maintains a database on failure in the construction industry. They identified five important causes of business failure in the construction as follows:

1. Bad profit
2. Inadequate sales
3. Management incompetence and lack of experience
4. Loss at market and economic decline
5. Difficulty collecting from customs.

Thomas C. Schleifer (1989) identified 10 causes of construction business failure. The first five are related to business strategies, and the second five are related to accounting considerations.

They are as follows:

1. Increasing project size
2. Expanding in unfamiliar locations
3. Replacing key personnel
4. Moving into new construction
5. Not maturing in management as business expands
6. Using poor accounting systems
7. Evaluating project profit incorrectly or not in time

8. Not controlling equipment costs
9. Not billing or collecting effectively
10. Jumping between computerized accounting systems.

## **4. Causes of Failures in Questionnaire**

Questionnaire is distributed to the contractors; this questionnaire includes four groups of failures, namely, managerial, financial, expansion and environmental causes. These causes are as follows:

### ***4.1 Managerial Causes***

They include important causes have strong influence in the contractor's failures. These causes will be as follows:

#### **1. Lack of Experience in the line Work**

The owner of the company should employ high degree of qualified working team in the company. This team should have good experience in the same line of work, also the owner should be.

#### **2. Replace key personnel**

Loosing any key person in any construction company is a big disaster. A new person needs three to six months to be familiar with company's policies and regulation, wit the new stuff and many contractors. Many contractors do not recognize the amount paid for learning period.

#### **3. Assigning project leader in the site**

Project leader should be qualified for the job because he is the vehicle for reaching project goals

#### **4. Labor productivity and improvement**

There is a direct relation between productivity and cost, productivity is not only very important term to a contractor but also it is the key to success or failure. Uncontrollable weather, worker moral and management supervision are the main factors influence the productivity.

#### **5. Bad decisions in regulating company policy**

Bad management decisions might not cause failure directly but they lead to failure. Decisions in regulating the company policy should not be taken unless all significant factors involved not only be considered but also handled in an accurate and correct manner so that the results will be satisfactory from all viewpoints.

#### 6. Use of project management techniques

Project management is the integral of all of the construction project functions which include coordination of subcontractors, scheduling, cost control, labor relation, billing, purchasing, expanding and other functions related to the project. Any shortage or missing in these leads to failures.

#### 7. Company organization

For each project there is a need to prepare an organizational chart which determines the grouping of activities, the authority relationships, and the communication channels between the groupings.

#### 8. Procurement practices

In the open country like Saudi Arabia, purchasing material with good quality and reasonable price is not an easy task. Therefore, it's recommended to have material specialist who can read specifications and decide the reasonable materials required for the company.

#### 9. Claims

When disputes do arise, the contractor should minimize them for two reasons. First, the costs associated with them, secondly, the contractor's name in the market will be destroyed. The contractor should quit the claim, even though he misses some of his rights, because the owner will complete his building and will disappear from the market, but the contractor will stay.

#### 10. Internal company problems

Each employee will have more loyalty to his nationality and will not prefer to work with another nationality. Also the problem between partners will have a bad effect in the company.

#### 11. Recruitment from one country

In Saudi Arabia, there are contractors who depend on certain nationality, which could cause failure in many cases. Workers from one country can build strong interrelation, which causes a problem to contractors.

#### 12. Recruitment from many countries

Even though, recruiting from more than one country can create competition between employees.



### 13.Owner's Absence from the company

No one can take the place of the owner in the company; even a full time manager can't manage like the owner, even if he has full confidence.

### 14.Using computer applications

Computer applications can help the contractor to do the work easily, quickly and accurately. Those contractors who are still using old methods are less productivity than the modern contractors.

### 15.Frauds

When the company is not planned, organized, directed and controlled, the chance of fraud will be higher. Frauds can happen various departments in the company.

### 16.Neglect

When the management doesn't respond to problems and suggestions, this may leads to add costs to the company.

## ***4.2 Financial Causes***

The financial stand of the contractor is very important for running the business. Work improvement sometimes needs money because improvement needs buying new equipment or developing new techniques. All the important managerial causes couldn't keep the contractor save without good financial stand. The financial causes are as follows:

### **1. Low margin profit due to competition**

The number of contractors would be expected to be high because of the simplicity of establishing firm in Saudi Arabia. Also, as the number of contractors increase, the margin of profit decreases. Consequently, the construction industry is highly competitive and the profit margin very small.

### **2. Cash flow management**

Availability of cash flow is very important for a contractor to run the business. Consequently, a contractor should plan for cash flow, or one day he will not have money to pay his expenses.

### **3. Bill and collecting effectively**

It's important to send the bill to customer on time. Adding charges to late submission of payment will encourage customers to pay on time.

### **4. Poor estimation practices**

Poor or inaccurate estimation will lead to fail in any construction project. The owner of the company has to employ expert person who can make accurate estimation.

### **5. Evaluate project profit in one fiscal year**

In construction, it's extremely difficult, in one fiscal year to know whether or not each project is making a profit or a loss before the project is completed

### **6. Employee benefits and compensations**

In Saudi Arabia, bonuses are not quite common. It's applied in large construction companies, but medium or small companies don't give bonuses. Bonuses encourage the employs to work harder and better.

## 7. Controlling equipment cost and usage

In buying new equipment, the contractor must decide whether to own or to lease. The more suitable for his business must be considered. Some contractors made the wrong decision, which effects on his final profit.

### ***4.3 Expansion Causes***

The expansion is the normal growth in any business. If the company doesn't develop, the companies, which are the same size, will develop and become stronger than the solid company. However, the expansion should be done under very good researching, planning, and controlling. The size of the company should be reasonable for the business to avoid failure. The expansion causes are defined as under:

1. Expanding into new geographic locations

The change from geographic area in which a contractor is usually bidding, achieving productive work and making a profit, can cause failure. The difference in customers, methods, procedures, regulations and labor conditions can be significant and expensive if not planned for.

2. Opening a regional office

When the contractor decides to open a regional office, he must have a plan for the office as a part of the plan. It should determine in advance of how long the contractor will continue the effort if it doesn't succeed, because making a profit in the first or second year is very difficult. If the losses exceed the planned amount, the plan should be reviewed.

3. Increased number of projects

A contractor must know his ability and maximum volume for each year. Overwork may lead to shortages and causes failures to satisfy every client demands

4. Increased size of projects

The most common factor of failure is the dramatic increase in the size of project, if the contractor is not aware of the safe ways to grow and expand.

5. Change in the type of work

The contractor should recognize the importance of researching and planning before taking a new type of construction. The entrance cost which is the money paid for learning period during which a contractor needs to learn a new type of work, is always under estimated. A

contractor may complete one or two losing projects before he can build a new type of construction profitably.

6. Lack of managerial maturity

A construction contractor who is running a fast growing often finds difficulty to determine the limit of his effectiveness. A contractor cannot predict the point at which volume will outstrip management ability.

7. Change from private to public or vice versa

There are many differences between private and public projects should be recognized by a contractor to avoid the failure. Quality for bid lists used criteria for selecting winning bids, amount of collaboration between parties and the quality of the work expected and delivered are the main differences between these two types.

#### ***4.4 Environmental Causes***

The environmental causes affecting the local area will be included in this part. These causes are defined as follows:

1. National slump in the economy

If the government doesn't have money, it will not offer new projects and contractors will run out of work.

2. Construction industry regulation in Saudi Arabia

The entrance to construction industry is very simple in Saudi Arabia. There is no limited education or good past experience for the company's owner. The only regulation is that he is not a governmental employee.

3. Owner involvement in construction phase

If the owner's key roles were prepared accurately and quickly, this will help the contractor to do work smoothly. However, if the preparation was not done properly, this will increase reworks, change orders and claims in the project.

4. Bad weather

The temperature and humidity has a strong relation with the productivity. As known, Saudi Arabia has high temperature especially in the summer. Therefore, the contractor must expect reduction in the productivity, which should be considered in bid estimation, during the summer session.

## 5. Questionnaire Results

These are the results of the questionnaire:

### A. MANAGERIAL CAUSES

CAUSES OF FAILURE	Very Influence	Influence	Slightly Influence	Not Influence	Can't Decide
lack of experience in the of work	53	14	0	1	0
replace key personnel	25	36	6	1	0
assigning project leader in the site	30	20	10	5	3
bad decisions in regulating company policy	39	23	2	2	2
labor productivity and improvement	32	27	7	1	1
use of project management techniques	19	34	8	4	3
company organization	28	28	9	3	0
procurement practices	19	31	10	2	6
claims	13	20	26	5	4
internal company problems	23	30	9	3	3
recruiting from one country	8	19	27	12	2
recruiting multinationality	6	8	21	32	1
owner absent from the company	34	19	10	3	2
using computer applications	12	20	12	22	2
frauds	29	21	11	5	2
neglect	46	19	1	1	1

## B. FINANCIAL CAUSES

CAUSES OF FAILURE	Very Influence	Influence	Slightly Influence	Not Influence	Can't Decide
low margin profit due to competition	25	28	14	1	0
cash flow management	24	37	6	0	1
poor estimation practices	44	20	3	1	0
bill and collecting effectively	32	21	11	3	1
controlling equipment cost and usage	20	35	8	5	0
evaluate project profit in one fiscal year	9	29	18	11	1
employee benefits and compensations	7	21	20	19	1

## C. EXPANSION CAUSES

CAUSES OF FAILURE	Very Influence	Influence	Slightly Influence	Not Influence	Can't Decide
expansion into new geographic locations	7	23	21	7	10
opening a regional office	1	19	25	14	9
increased number of projects	11	21	21	13	2
increased size of projects	22	24	15	6	1
change in the type of work	12	36	14	4	2
lack of managerial development or maturity as the company growth	29	28	8	2	1
change from private to public or vice versa	2	10	25	27	4



#### D. ENVIRONMENTAL CAUSES

<b>CAUSES OF FAILURE</b>	<b>Very Influence</b>	<b>Influence</b>	<b>Slightly Influence</b>	<b>Not Influence</b>	<b>Can't Decide</b>
<b>national slump in economy</b>	38	23	5	1	1
<b>construction industry regulations in KSA</b>	15	15	19	11	8
<b>owner involvement in construction phase</b>	17	22	13	10	6
<b>bad weather</b>	4	18	29	14	3

## **6. Conclusion**

This report discussed the causes of failures among the contractors in Saudi Arabia. There are thirty-four causes, which are combined into four areas, namely managerial, finance, expansion and environmental causes. A questionnaire was distributed among different levels of contractors and a table is established to show the questionnaire results.

## **7. Recommendations**

1. It's recommended that a set of procedure e established to restrict the construction industry. One of the set procedures is the restriction of owner. The owner of the company should be qualified much as a lawyer or an engineer is.
2. Contractors should improve the practices for calculating the project costs. A contractor may request the owner to provide him with take off quantities with prepared by the design office,. These quantities would be more accurate because the designer knows more about the project.
3. It's recommended that the number of payments increase to reduce the amount of each. Also, the contractor should include extra charges for late payments
4. It's recommended that each contractor establish a program for motivating workers. This program should be designated to cover as many workers as possible.

## **Reference:**

Adel Al Barrak, Causes of Contractors' Failures in Saudi Arabia, June 1993