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Turnaround Tactics

B2B creditors can help faltering customers by taking a leaf from the banking workout playbook: Call in the turnaround experts.

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Credit managers have long found themselves limited to a few responsive actions when they find that a key customer is experiencing financial distress. Placing the troubled customer on credit hold, re-evaluating the customer's credit line, and holding pending shipments are often-used techniques for managing credit risk. However, these actions can threaten the viability of the troubled customer's business.

This situation creates a dilemma: The credit manager, while trying to control credit risk, may threaten the customer's survival, as well as the supplier's future sales and profits. Pressure from the sales, manufacturing, and accounting functions may place the credit manager in the difficult position of having to hold fast at the cost of internal harmony, or concede to these pressures — at financial risk to the company. There is another option. Credit professionals can make use of turnaround and crisis management professionals to manage risk more effectively and help maximize their troubled customers' chances of survival.

It should be no surprise that, in terms of activity, traditional business credit surpasses commercial lending in dollar volume. However, it is a surprise that, when a good customer relationship goes bad, the credit manager, not the bank workout officer, has more tasks to juggle and more balls to keep in the air. A bank has the luxury of being single-focused: The bank wants to be paid, period. In these situations, a bank workout officer may send in advisors to get a better understanding of just how troubled the customer is, and increase the lender's ability to make informed decisions. The bank may also provide the customer with a list of turnaround and crisis management firms and suggest that the customer obtain outside assistance in fixing itself as a requirement for moving forward. Of course, with a blanket lien on the borrower's assets, which banks often have, it's easy to dictate terms to a troubled customer.

Credit managers, on the other hand, have a more complex task. A credit manager who discovers that a customer is in distress has many difficult decisions to make. In addition to the obvious decision about extending credit, there may be non-credit risks to manage, including managing the purchase of raw materials, being on the alert for shipments or production in progress, and assessing any company strategic plans that count on the viability of the troubled customer. Because of this level of complexity, credit managers can, and should, avail themselves of the same tools that banks have used so effectively.

When a key customer begins to show signs of distress, credit professionals can take proactive steps to protect their company's interests while helping the troubled customer weather the storm. This type of approach is not new. Many companies have stepped in to assist critical supply chain partners. In industries, such as auto and aerospace, where a finely tuned supply chain is crucial, stronger companies have often dispatched assistance when necessary to restore the health of their suppliers and customers.

A credit manager who retains a turnaround professional to perform an assessment of a troubled customer is getting a seasoned business manager who knows exactly what to look for. Turnaround professionals know how to measure risks to the viability of a troubled company. If the distressed customer is unable to provide cash flow forecasts, updated financial statements, or other key information, the advisor can generate information to aid the supplier in sound credit decision-making. Basing credit decisions on past customer-submitted financial statements, when the customer is in trouble, is inviting disaster. After all, invoices aren't paid by EBITDA. Cash pays invoices, and the creation of a 13- or 26-week cash flow model is of prime importance.

As part of an assessment, a qualified turnaround professional can quickly diagnose the troubled company's situation and determine if the basic requirements for a successful turnaround exist:

- A viable core business (or businesses);
- Sufficient organizational resources and knowledge; and
- Adequate financial resources to allow the company to survive through the turnaround period.

Making this critical determination usually takes a short period of time. The turn-

around professional can then offer a prognosis and provide detailed information about the company's outlook and the actions required to return it to operating health. Along with this assessment, of course, the supplier receives a better picture of its own overall risk.

Once the advisors are engaged and a clearer picture of the customer's business emerges, suppliers may want to evaluate their options before acting. Credit managers must consider all the potential impacts of the credit decisions they make. Regulatory and social ramifications may be a factor in sound credit decision-making. A sudden reduction or cessation of credit can push even a healthy company over the brink, creating a domino effect that ripples through the troubled company's supply chain.

In addition, if the decision to withhold credit severely damages the customer, after the supplier has assured the customer that credit would continue to be extended, the supplier may find itself the target of litigation. A turnaround advisor can assist the credit manager in evaluating these dangers.

Termination of the supplier-customer relationship may also create problems for the supplier beyond the unpaid receivable. If the customer purchased custom products, there may be work-in-process, or WIP, and/or inventory for that customer that cannot otherwise be sold. In such cases, it may be beneficial to continue shipments while inventories are depleted and WIP is reduced, while the supplier exercises more oversight and coordination of the functions affected by credit decisions – including the production, purchasing, shipping, sales, and accounting departments.

If it appears that reorganization or liquidation in bankruptcy are likely outcomes for the customer, the supplier and advisor should develop a strategy for minimizing the risk of "preferences." Analyzing the customer's payment practices and building industry-wide knowledge are useful steps in preparing the "ordinary course" defense against preference claims. Keeping an eye on the 90-day preference period is crucial for the supplier's planning purposes, and the turnaround advisor can, as part of the engagement, not only track the preference clock relative to the supplier, but also give the client an understanding of the whole preference picture. Because turnaround advisors are not engaged as attorneys, they work with the credit manager and the supplier's counsel to assist in the evaluation of the supplier's preference concerns by providing valuable information and context.

If the advisor finds that the troubled customer is insolvent, and the credit manager determines that his or her company should not continue to extend credit, or if the customer's situation deteriorates, the advisor can assist in evaluating the supplier's immediate options – including exercising reclamation rights under the Uniform Commercial Code. Because these rights can be exercised only within a narrow window of opportunity, a turnaround advisor can provide valuable assistance in forecasting such an eventuality and preparing for that step.

Limits to Advice

Retaining advisors to evaluate a troubled customer is not without its concerns. Credit managers should be sure to structure the engagement of turnaround professionals properly to avoid the risks of "lender liability" and "equitable subordination." Ideally, the troubled customer can be convinced to engage a turnaround professional directly. In which case, it may be beneficial for the supplier to have a list of known and trusted turnaround practitioners to whom the customer can be referred. When the customer does the hiring, the turnaround consultant should report to the customer's Board of Directors and be permitted to share findings and recommendations with outside parties, such as the company's critical suppliers and stakeholders.

However, if the troubled customer resists engaging outside help and the supplier must send in its own advisors, it should be clear that the advisor is only to gather and analyze information. The consultant and the credit manager must take steps to ensure that the advisor, as the supplier's agent, does not appear to be telling the customer how to run its business.

When a troubled customer retains a turnaround advisor, it increases the likelihood of the supplier being repaid and the customer remaining viable. Credit managers can make the most of this situation by understanding what a turnaround professional can and cannot do.

Turnaround professionals are bound by their obligation to the client, but reputable turnaround professionals are not advocates in the sense that some attorneys are. Rather, they are objective analysts, reporting their observations and providing a realistic assessment of the situation without partisan subjectivity. This practice of "calling balls and strikes" allows the turnaround professional to establish credibility with all the stakeholders and act as a powerful agent for change.

Credit managers should take the opportunity to seek out the turnaround professional and apprise him or her of their concerns. Initiating this dialog facilitates two-way communication, since the turnaround manager may want to provide information to creditors regarding the distressed company's situation and its progress through the turnaround process. Turnaround professionals recognize that suppliers are crucial to the client, and they understand that the quality of information provided directly impacts the quality of the decisions that credit managers make.

Trust is one of the first casualties of a supplier's relationship with a troubled company. Missed payments, broken promises, and unmanaged expectations put a strain on the supplier-customer relationship. In many cases, credit managers are left "holding the bag" if they made a credit decision based on bad information from a customer. The credit manager should view the turnaround advisor as a means to reduce surprises and obtain more accurate, up-to-date information on a more regular basis. Reputable turnaround professionals watch the infor-

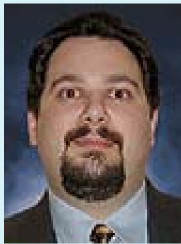
mation flow to suppliers and should ensure that the client is not over-promising and under-delivering.

Ask Questions

Credit managers should ask questions of turnaround managers. Ask to see cash flow forecasts or proposed payment schedules. Ask about the assumptions behind these forecasts. Raise concerns where they are warranted. Short of divulging confidential information, turnaround managers should be able to provide key suppliers with meaningful information to assist in the decision-making process, because that serves both the customer's and suppliers' needs. However, credit managers should view the turnaround professional with the same care they would if the advisor worked for their firm and take care not to be perceived as attempting to dictate the actions of the turnaround consultant or customer.

Whether the troubled customer or the concerned supplier retains the turnaround professional, the credit manager should be aware of certain constants. Turnaround specialists who are members of the Turnaround Management Association are bound by a strict code of ethics, which requires, among other things, a commitment to: maintaining the integrity of the client by keeping client information confidential; serving all clients independently; and continuing their education. Turnaround professionals who have earned the Certified Turnaround Professional designation have passed a thorough, multi-part exam that encompasses the principles of turnaround management, law, and finance; passed an extensive peer review process; undergone reference and background checks and client confirmations; and have a verified work history, including a minimum number of years as a practicing turnaround specialist. CTPs also have stringent continuing education requirements.

Credit managers find themselves making difficult decisions regarding troubled customers on a daily basis. When those decisions impact key customer relationships, they should consider using outside professionals to gather and enhance their information. Using turnaround professionals to expand the credit manager's knowledge and capabilities may not only reduce the supplier's overall risk and increase the likelihood of getting paid but, when a financially troubled customer is successfully turned around, it may also contribute to a longer relationship with a healthy customer.



About the Author

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