

DON'T IGNORE THE SYMPTOMS:

Ten Warning Signs of Your Customer's Impending Bankruptcy

By John A. Roberts, Esquire

It used to be a simple matter to determine if your customer was a likely candidate to file for bankruptcy: just check to see if the client had its name on a professional sports arena or ballpark. That's what Enron, MCI, United Airlines, Conesco, Adelphia and TWA all had in common. Likewise, remember the erstwhile USAirways Arena in Largo, Maryland, as well as PSINet Stadium right here in Baltimore. Nowadays, the warning signs might not be so big or well-lighted, but they are apparent to the watchful credit manager. Here is one "Top Ten" list of common warning signs of an impending bankruptcy:

1. Problems with Payment Checks. Obvious problems include a bounced check, an unsigned check, and a post-dated check, the latter indicating that the customer does not have sufficient funds to make payment at present. A less obvious warning sign is a check dated several weeks before you receive it, indicating that the customer waited for quite a while before sending the check, because it did not have sufficient funds to cover the check when it was written.

2. Abrupt and Unexplained Changes in the Pattern of Payment. Customers usually pay invoices regularly, even if the regular pattern is outside of invoice terms. Flag the account if the payments become progressively later, if the customer stops taking advantage of discounts for prompt payment, if the customer starts making partial payments, or if the customer starts using delaying tactics before paying invoices. Delaying tactics might include demands for proof of shipment, unwarranted complaints about shipments, or promises to pay invoices upon the occurrence of some future event, such as the sale of an asset or the closing of a loan.

3. The Customer Fails to Respond to Inquiries, or Gives Evasive Responses. "The check is in the mail." Need we say more?

4. Changes in Pattern of Purchases. The customer is making more orders of smaller amounts, indicating that the customer is having cash flow problems and cannot pay for large orders that had been made in the past. More insidious is the customer that starts making much larger orders on credit in order to stockpile product for an impending bankruptcy.

5. A Sudden Change in Vendors with Whom the Customer Has Had a Long-Standing Relationship. The good news is that you and your sales staff have landed a new customer, stealing the customer away from a vendor with whom the customer has been doing business for many years. The bad news is that the reason for the customer's change of vendors is that his old vendor is no longer extending credit to this customer because of payment problems.

6. "Word on the Street". Listen to rumblings in your business community about the financial health of your customers. Rumors often have a basis in fact. Also, listen to intelligence gathered by your employees who manage the relationships with the customers. Your sales people will know whether the customer's pattern of purchases has changed. Your accounts receivable people will know of problems with payment checks or a change in pattern of payment. Your delivery people will know whether the customer has been stockpiling inventory, or if the customer's warehouse is overloaded with obsolete inventory.

7. Key Personnel Have Left the Customer's Employ. If the customer's bookkeeper or comptroller has recently left the customer's employ, abruptly and without explanation, it may be a sign that the customer is having problems. If the customer has laid off other employees who are important for customer relations or quality control, it is likely a sign that the customer is cutting costs due to financial difficulties.

8. Issues with Key Personnel. Especially with small businesses, personal issues encountered by key personnel can have a detrimental effect on the business. If your customer is a "mom and pop" shop, and "mom and pop" are in the middle of a divorce, the shop is going to be adversely affected. In a family-run business, when the generation of current management is ready to retire and there is no Sonny or Michael to take over the business – only Fredo – the business will suffer.

9. The Customer Is in an Industry with Problems. If your customer is an airline, an automobile manufacturer, or another industry that is in a well-publicized downturn, or if it is a company that relies on any of these industries, it is already experiencing problems, and it is not going to get better soon.

10. Key Material Costs. If your customer is heavily dependent upon steel, gasoline, or any other commodity that is rapidly increasing in price, and the customer has not foreseen these increased costs, it will soon be in a cash flow crisis. Consider yourself warned.

If you are facing a bankruptcy or other debtor/creditor related issues, please contact John A. Roberts (410-727-6671, or jroberts@rosenbergmartin.com). If you have any other corporate or business-related needs, feel free to contact John or any attorney in our corporate group:

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