Early Warnings Signs of Corporate Disease

As Credit Practitioners, it is imperative that symptoms of an ailing business be recognized in order to avert those profit drenching losses. The detection of a disease does not necessarily mean that it will be terminal. With awareness of the problems, a treatment plan can be delivered to determine the corrective action required. This action needs to be treating more than the symptoms but also the root causes. The process of detection can either be a self-diagnosis or accomplished by another form of corporate doctor. In either case, the corrective action prescribed must be routinely administered. This will increase the chances of having the ailment rectified, the firm returned to health (usually profitability), and be given a favorable prognosis for the future.

1) A negative Change to Payment Patterns
   If the borrower/customer was previously paying at your established terms of sale and breaks ranks by a significant number of days, the question "why" needs to be asked. Are payments to suppliers being stretched in order to pay down bank credit facilities due to lending covenants being off line, or are payments consciously being delayed due to severe cash flow limitations? Suppliers can be the first to recognize these early warning signs. If commitments as to terms and payment time lines are not being met, the very core of the business relationship, trust, may be in question.
2) Credit/Collection Calls Emails Not Being Returned
   If calls or emails are not being returned routinely on a timely basis and in past history there was no experience of this type of non-response it definitely can be a warning sign. Borrowers at times try to duck calls, hoping that the problems that are here to-day will be gone tomorrow. Hand in hand with this go untimely remittances. It may even be that payment will not be forthcoming, until calls are placed. Consistent and persistent calls along with further investigation may be the extensive effort required in order to be the squeaky wheel that gets the grease. As a provider of credit facilities you are entitled to full and complete answers in order to adequately protect your firms' interest.
3) Numerous Claims, Credits and Returns
   This tactical maneuver by a borrower to forestall payment attempts to put the onus back on the supplier for deficiencies. It may be in fact that the client over purchased or they may be grasping for a price concession as well as a temporary cash flow reprieve until the amount owing is finalized. Does the value and number of these credits coincide with a normal percentage in relation to sales to that client?
4) Returned Checks
   Regardless of whether the non-sufficient fund check is received directly or information of its existence is obtained from another supplier or it is noted on a bank report, where there is smoke there is normally fire. Are the credit facilities at or exceeding their established limit, or is the very support of the primary lender in question.
5) Industry Trade Groups
   Industry trade groups provide a vital link into sourcing up-to-date pooled information. Negative details obtained about a client can be an indicator of serious underlying health problems. These

groups are a forum for the exchange of past and present information which assists each member firm individually in assessing the overall health of the firm. Payment trends in this broader scope add a valued dimension in the individual client review process.

6) Public Record
Suits, liens judgments as well as fresh security provided to lenders all help to diagnose the overall fundamental picture of the client. Lenders demanding fresh additional security may be a very important critical signal. Also a substantial lawsuit against a firm, if successful and judgment awarded may cause a terminal illness.

7) The Grapevine
A limited amount of information sourced vis-a vis this method may prove to be true but never the less it is prudent to investigate it fully. Seasoned practitioners routinely know who consistently low balls prices in order to capture market share. The majority of businesses have more to compete with than just price alone. Much like with the other warnings signs, upon completion of the investigation, it may be that there are other legitimate reasons for these changes and financial impairment may not in fact be at hand.

Business Illness could be caused by, but is not limited to the following:

- Under capitalization
- Growth too quickly
- Sales decline (more competition, changing marketplace, technology, pricing)
- Accounts Receivable escalation
- Inventory escalation (over purchasing, outdated products)
- Withdrawal of funds (dividends, ownership loans,)
- Expenses too high for the profit margins and revenue base
- Rifts between owners
- Lack of marketing effort or direction
- Poor communication
- Weak Management
- Key employees leaving the firm
- Environmental changes (product or location)
- Economic changes in sales territory

There is not a failsafe test to detect the root cause of a fundamental business downward spiral from the outside. Being cognisant of early warning signals, as well as using instinct and common sense in conjunction with taking strategic timely action can assist greatly in protecting your firms' valuable asset, the accounts receivable portfolio.

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