

# Supplier Insolvencies - Are you at risk?



## **The number of company insolvencies double in Qtr 1 2009 – How can you protect your company from supplier insolvencies**

On May 1, 2009, the National Insolvency Office reported a total of 4,941 company liquidations in Qtr 1 2009 in England and Wales. This is an increase of 56% on the same period 1 year ago. The risk of one of your suppliers declaring bankruptcy is increasing in the current economic climate. So how can you protect your company from the economic fallout? Here we look at how to check your suppliers, who to check, and what to do if the worst happens.

The most obvious way to check up on a supplier is to run a credit check. For a fee, a number of different credit ratings agencies, such as Equifax, offer this service, or most banks also offer a credit rating service. It's worth noting that there is currently no universal credit rating system in the U.K. A lender devises it's own set of criteria on which to score against, so different lenders can give the same company a different credit rating. However, it will provide you with a fairly good idea of the financial health of your suppliers.

There are also a number of background checks you can run to see how your suppliers are weathering the economic storm. Quarterly financial statements are a good way to assess general financial performance, and it's also possible to see from these whether the supplier is heavily reliant on one specific industry sector. If that sector is showing a general downward trend, your supplier may be in for a rough ride.

Similarly, you should check your suppliers' key customers. Are they heavily reliant on one company alone? If they are, how financially sound is that company in turn? It's also worth investigating whether a larger company owns your supplier. If they are, are they likely to be sold off in tough economic times?

One informal route to consider when checking a supplier is the use of procurement chat forums and blogs. If another company is having trouble with a supplier, you may pick up some initial warning signs here.

Another area to look at closely in the current economic climate is your supplier contracts. Check your contracts with existing suppliers to see whether they allow for termination of contract if another company takes over. Also ensure you and your supplier are both clear about liabilities and obligations.

It's also important to ensure that contractual obligations are being met on your side. Check your commitments are being upheld and all paperwork is in place. If there is a problem in the future, the supplier will be less able to wriggle out of their obligations.

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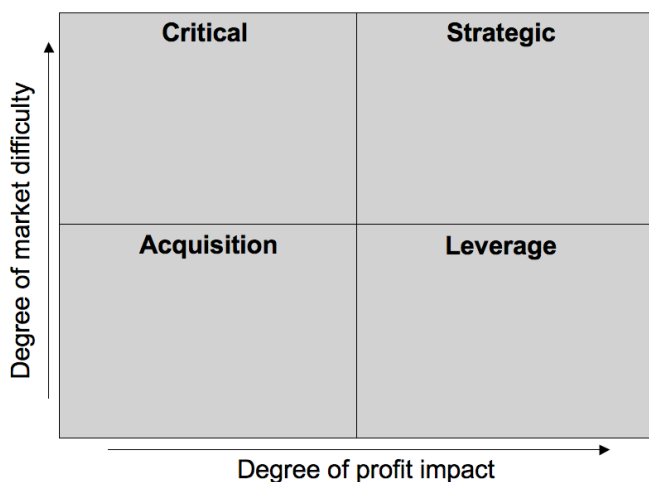
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Monitoring supplier contractual obligations should also be stringent. Any disruptions to delivery schedules, delays in payments etc, could all be signs that something more serious is occurring.

Finally, contingency planning is an important part of the process. What happens if a supplier folds? There may be little you can do, but if a proper procedure is in place, alternative suppliers already sourced etc, you may avoid decisions having to be made without proper consideration. A little of the panic may be removed from the process.

Business Interruption Insurance, or 'Loss of Profits' insurance, may also be worth looking into. The purpose of this insurance is to restore your business to the same financial position as if the loss had not occurred. It's also worth considering the damage to your company may not only be financial. A supply failure may also damage your company product / service and image. Other areas of the business may also suffer as time and resource is diverted to the immediate concerns.

In reality, limited resources will mean that it isn't possible to check all your suppliers all of the time. So how do you prioritise? Probably one of the simplest methods of prioritising is to use Kraljic's Portfolio Analysis Matrix, (Kraljic, 1983). Figure 1 below shows the matrix.



After plotting your area of spend or product on the chart, (for more help with this see O'Brien, 2008), it is easier to see the risk the suppliers of products or services in each quadrant pose.

Suppliers of a product or service within the Strategic quadrant are those who pose the most risk to your business if they were declared bankrupt. In this quadrant, it is difficult to switch suppliers easily, there is a limited supply of the product or service they provide, and the impact any disruption would have on your profit is high. These are the suppliers that should be checked regularly and in-depth, and a thorough contingency plan should be in place.

Suppliers of products or services within the Leverage quadrant should also be regularly checked and contingency planned. Although the market difficulty is lower and the product more easily come by, the impact their product has on your profit is still high. If they became insolvent, it would have a major impact on your company. However, as the market difficulty is lower, it should be easier to contingency plan in this area.

Suppliers of products or services in the Critical quadrant should also be looked at, as it would be difficult to switch suppliers if they did declare bankruptcy. However, these are of lower priority, as there is a lower degree of profit impact.

Finally, the suppliers that fall within the Acquisition quadrant would be the lowest priority for checking. There are lots of suppliers and their product or service has a low impact on your profit. However, it is worth looking at these if resource allows.

Even if you follow the above guidelines, there is still little you can realistically do to actually stop one of your suppliers going into liquidation. So what can you do if one of your suppliers does go bust?

The key is to concentrate on how it affects your own customers' expectations. Damage limitation is vital and should be a priority. Communication plays a pivotal role in this. Focus on your customers who are likely to experience shortfalls or delays and communicate any issues with them. Talk to bank managers, investors etc and explain why cash flow and budget forecasts may not go to plan and the reasons. You may also need to increase overdrafts etc to cover the transition to a new supplier. If you have a contingency plan, action it quickly and ensure all interested parties are kept fully informed.

Financially, it may be worth attempting to claim back any loss. If your supplier was a sole trader or partnership, you can sue for goods or services paid for but not received. It is unlikely you will get back all that was lost, but you may be able to negotiate a portion.

If your supplier was a limited company, they could have gone into liquidation or administration. Administrators can return money for goods or services that are undelivered, but only if the supplier had sufficient funds. If the goods are ready and have just not reached you, you are entitled to receive them. If the goods were paid for by credit card, you may also be insured.

Claiming back any monies or goods lost is likely to be a time consuming process. It's worth comparing the amount of resource needed to chase and extract any remuneration against the amount you are actually likely to get back. It may end up costing you more to claim than the amount you receive in compensation.

All forecasts point to the number of insolvencies climbing throughout the rest of this year. For those suppliers who pose the most risk to your business, it is worth allocating time and resource to monitoring the warning signs and being prepared for the worst. However, bare in mind your suppliers will probably be doing the same to you.

Sally Pearce, June 2009

References:

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