

EXPERTS' FORUM | Bank/Financial

Is Counter-party Risk Lurking For Your Business?

Every business operates within a network of relationships that include customers, suppliers, banks and insurance carriers. Trouble at any node in this network can mean trouble for your business, and this potential "trouble" is called counter-party risk.

Over the past 18 months as the economy has deteriorated, the level of counter-party risk has grown exponentially. However, many owners and managers still do not address the issue in a systematic fashion.

So what's the risk to you? Quite simply, it's the risk to your ability to maintain a proper flow of product out the door and money back in. Failure or slowdown by any of your network partners can adversely affect your ability to perform, and maintain profitability. The key is to not assume that things will continue on just as they have in the past.

Let's look at each of the major players in your network, and how their performance and actions could impact your business.

Customers – The critical issues here are sales, and ultimately, collecting the amount due from those sales.

- Are your sales people watching for and sharing with you any trouble signs in terms of the buying patterns of your major customers?
- Do you carefully monitor payment patterns? How do you handle late receivables?
- Is your credit policy appropriate and up to date? Do you establish credit limits for larger customers?
- Have you considered credit insurance?

Declines in sales are generally obvious. Stretching out of payment terms can become the silent killer. In a worst-case scenario, sudden bankruptcy on the part of a customer will rapidly generate negative margins—all the cost, with none of the revenue.

Suppliers – Any hiccups in your vendors' business can quickly affect your ability

to deliver on your promises.

Talk with their management on a regular basis—face to face, if possible—in order to stay current on their business, and to detect early signs of trouble.

- How is their business doing? What do they see on the horizon?
- Are they stressed by growth – or a sudden drop in revenue?
- Do you have alternative resources if one of your key vendors could no longer support your needs?

You are the customer, but if your suppliers become strapped for cash, they may find it necessary to accelerate payment terms. Switching terms net 45 days to net 30 days with a major supplier may significantly affect your cash flow.

Other Relationships – it can be easy to forget about other relationships affecting the success of your business.

It is a tenants' market today. Landlords may be open to renegotiating lease terms, but may require that you provide them with a letter of credit or personal guaranty. This is the landlords' way of controlling counter-party risk by insuring their receivables. How easy is it to work with your landlord?

Spending time with your banker, maintaining an open, honest relationship, is always in your best interest. An effective banker will ask a lot of good questions, and offer some very good suggestions—with the goal of helping protect and grow your business and theirs. In terms of counter-party risk, be sure to ask how their business is performing and if there is anything that might impact your access to credit.

Counter-party risk doesn't have to lurk in the shadows, but by asking the right questions, you can better prepare yourself and your business for potential impacts to your bottom line.



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