How to Identify a Potential Bankruptcy

As Congress continues to find ways to assist businesses and individuals, stimulus and Payment Protection Program money has been spent, leaving those businesses and individuals no better off as COVID-19 continues to wreak havoc. Common sense and logic point toward major issues arising in the coming weeks and months as the potential for unpaid bills piles up. When invoices go unpaid, it starts a downstream trend no business or person wants to see. Many businesses have already been impacted, e.g., Neiman Marcus, J. Crew, Intelsat. Many more businesses are also on the verge of bankruptcy and will most likely file soon.

In the April Credit Managers' Index from NACM, fillings for bankruptcies worsened but remained in expansion territory. "This is a situation that will worsen in time as more companies find themselves in trouble," said NACM Economist Chris Kuehl Ph.D. Total bankruptcy filings declined 46% in April compared to April 2019, according to the American Bankruptcy Institute. However, total commercial Chapter 11 filings increased 26% year over year. It's only a matter of time before the unpaid invoices are too much to handle leaving creditors holding the bag.

"The economy we're experiencing and will be experiencing in the coming year will be very difficult," said John Salek, president, Revenue Management Associates LLC, in NACM's recent webinar "Predicting Customer Bankruptcies Fast and Accurately in the Coming Depression." He added, "There will be more bankruptcies among your customer base than in the past. The biggest challenge will be achieving a breakeven sales value while controlling who you sell to."

Most companies sell to a range of customers, and credit departments have standards that will have to change with the times. It's important to work with customers to accommodate them. It's also vital to update risk assessments on all customers. Credit information, even from early March, is too old and not relevant anymore.

There are a number of ways to identify a potential bankruptcy, and from different avenues. Key factors can be identified by the sales, service and collections teams, and from credit investigations. Salek developed a top 10 list to help identify potential bankruptcy candidates.

The Top 10 List
Adverse news events
Bounced NSF payments
Bond default, forbearance and/or price deterioration
Financial deterioration documented through financials
Delinquent payments
Extended payment term/higher credit limit requests
Broken promises
Significant increase in invoice disputes
No contact
Failure to supply financials.

The top benefit of improved bankruptcy prediction is the survival of your company, noted Salek. It's important to maximize the cash flow from orders filled with existing inventory, retained services and staff while optimizing the cash inflow from orders filled with newly purchased inventory.

Most companies will have lower revenue and lower cash inflow during this time. “It is imperative that customers pay at least most of what is owed in the short to medium term,” Salek said. Identifying high-risk customers and forecasting cash flow scenarios is also important.

The second of Salek’s two truths, the first being that there will be an increase in bankruptcies, is that credit professionals will have to sell on credit to uncreditworthy customers to make their breakeven sales volume. “This goes against everything we have been taught and practiced,” Salek said. There’s a big question that credit departments must ask themselves. Why are they receiving requests from new customers? One potential reason is their current supplier cut them off for nonpayment, so it’s important to watch the department’s exposure to make sure payments are made on a timely basis.

-Michael Miller, managing editor