

ORGANIZED TRADE: A CONCEPT THAT MAY FAVOR THE SECURED LENDER

by Daniel M. Morris, Carl Smigiel
and Fred Slamin

In the current period of excess leverage and increasing bankruptcy filings, secured lenders are learning not to use the "L word" (Liquidation). Rather than liquidating under-performing and troubled accounts, secured lenders are seeking effective ways to revitalize them.

An organized trade can be a valuable ally in effecting the turnaround of a troubled debtor, maintaining lending and trade opportunities while enabling the company to both meet its secured obligations and satisfy its unsecured debt repayment programs.

An organized trade is a coalition of suppliers that have business relationships with a particular debtor company and that utilize common representatives such as accountants, attorneys and consultants to deal with the troubled debtor. These groups are most prevalent among retail suppliers, suppliers of raw and processed materials such as lumber, plastic resin and paper, and suppliers of machinery and equipment. They are commonly organized through professional service or credit associations, such as the National Association of Credit Management, as well as trade associations serving specific industries.

New complexion

For the secured lender, an organized trade has taken on a new complexion. In the past, organized trade vendors generally were not well informed about the complex process of working out a troubled credit. At the same time, secured lenders usually felt that if a loan was adequately covered by collateral values at hand, there was little advantage in utilizing an organized trade. In fact, influential vendor groups often were viewed as a threat because they could affect the secured lender's ability to collect its loan or continue providing credit in certain circumstances.

However, in this era of lessened new loan opportunities and under-collateralized credits, secured lenders are discovering the advantages of using an organized trade during a loan workout, including the possibility of salvaging profitable account relationships.

Working in concert, the company, its secured lenders and an organized trade can often arrive at an informal arrangement to satisfy existing debt, thus averting a Chapter 11 bankruptcy. In most situations, both secured lenders and

trade creditors achieve a better result in an out-of-court workout because of the potential for a larger recovery due to reduced expenses, shortened time frames required for action and greater control in the hands of business people.

Organized trade benefits

By recognizing that the troubled company is not in a position to pay back its existing debts and continue current operations, an organized trade has the ability to ease tension by lessening demands to satisfy old payables and to stimulate recovery by focusing on methods of assisting the debtor. In this respect, the trade creditors must view past obligations substantially as equity that cannot be withdrawn until the company returns to profitability and positive cashflow.



Daniel M. Morris is the founder and president of Morris Anderson & Associates, Ltd. He received his J.D. from Northwestern University School of Law and his B.S. in accounting from Miami University.

An organized trade can assist a financially distressed account by providing limited and controlled new credit, in short "priming the pump." In this way, the debtor can continue operations, halt its "downward spiral" and move toward stability. With the secured lender's consent, a specific amount of new trade credit can be repaid out of current cashflow.

In a recent case, trade creditors banded together to assist a company whose production and shipments had been greatly curtailed because of a lack of working capital. Organized trade made an arrangement to establish an escrow account to pay for new material on 10-day credit terms. Secured lenders were willing to allow an escrow to be established (modest overline) even though the company was exceeding its borrowing formula. In addition, plant and equipment lessors permitted the company to operate on a month-to-month basis and refrained from exercising their rights and remedies to collect past due rents. When this

arrangement (coupled with expense contractions and other stabilizing activity) proved to be satisfactory for a few months, the suppliers provided extended credit terms based on a workable recovery plan presented by the company.

The above technique is especially advantageous to the secured lender whose loan is under-collateralized. The secured lender's funds are normally not required in large amounts if the debtor company is operating at a cash break-even.

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In some situations, an organized trade may establish special warehouse or "locker stock" facilities for troubled accounts, which are documented through the use of inter-creditor agreements. All merchandise is shipped to a secure warehouse and released to the company on a cash-on-delivery basis. This allows the company to significantly reduce cash requirements for the inventory while still being able to replenish its needs. In the event the company fails, the remaining stock is returned to the vendors.

Many trade vendors maintain sophisticated systems for accounts receivable management and collection. Such vendors can provide valuable help to a troubled account in collecting its receivables. In most industries, an organized trade can also offer advisory assistance in other key operational and technical areas.



Carl Smigiel, a senior consultant at Morris Anderson, is a specialist in commercial banking, real estate and credit. He received his law degree from John Marshall Law School and his Bachelor's degree from the University of Michigan.

Professional input

The involvement of a reputable and experienced turnaround consultant is usually a positive step for secured creditors and trade vendors alike. A consulting firm may be engaged by the company, the secured lender or the creditors committee (ruling body of trade vendors).

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Most business managers have not had experience dealing with a financial crisis and may not be able to function effectively under a stressful workout environment. Existing management also may have lost credibility with creditors and investors, does not know how to communicate effectively in troubled circumstances and cannot execute objectively its fiduciary responsibilities. Using a tested consultant is often the quickest and best way to pinpoint underlying problems and help take necessary recovery action. A consultant helps stabilize the company's operations and cash position, mediate among all stakeholders and implements a solid turnaround/workout plan.

Of course, it is the secured lender's and cash stakeholder's responsibility to assure that its interests are served as fairly and effectively as possible in a workout. The first step for all creditors without clear-cut and reliable exit strategies is to open creditable communication channels with key stakeholders. An appropriately formed workout team can then assess the debtor's liquidity, uncover the true causes of its problems and develop a reasonable, equitable workout program. The secured lender, trade creditors and other stakeholders can look to the same plan performance standards in assessing management's achievement and negotiating the future availability of credit. The consultant can guide the stakeholders through the process and assume implementation responsibility where necessary.

Current economic trends, compounded by a rising number of business failures, has narrowed the number of favorable secured lending opportunities. Vendors are also finding that they have a reduced number of opportunities (new and regular customers). In such a business climate, secured lenders and organized trades have common interests. By working together they can resolve under-performing or troubled account situations, preserving business for both. ▲



Fred Slamin, also a senior consultant at Morris Anderson, specializes in financial analysis as the basis for profit planning, cash management and cost control programs. He is a graduate of the University of Notre Dame and a C.P.A.