

## The Art of Managing Vendor Negotiations & Communications in a Turnaround

BY AARON G. GILLUM

**In this environment of economic uncertainty,** a company ignoring phone calls from angry suppliers and stretching trade credit is a tell-tale sign of distress. Although this approach may find temporary relief for management, it only delays the inevitable. Eventually every company in this situation will need to face reality head-on with its key stakeholder: the supplier base.



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**F**or nearly four years, businesses have had to cope with a recessionary economy and tight credit markets. The businesses that have prevailed (or at least survived) often had to become crafty in their approach; they almost had no choice but to develop new models for operations. This is particularly true in the middle-market space, where competition is fierce and options for financing have been reduced or, in some cases, eliminated. In this environment of economic uncertainty, a company ignoring phone calls from angry suppliers and stretching trade credit is a tell-tale sign of distress. Although this approach may find temporary relief for management, it only delays the inevitable. Eventually every company in this situation will need to face reality head-on with its key stakeholder: the supplier base.

### **The Situation — The Unknowing and Reluctant Financier**

Working capital, free cash flow from operations or cash availability from any source has become a scarce commodity as banks have slowed lending and

private equity funds have only begun to re-introduce themselves to the market. Increased awareness and management of this scarce resource has become critical for many middle-market companies. When traditional sources of working capital have dried up, companies are forced to turn to the supplier base to survive a short-term cash crunch. Neither party planned that the relationship would evolve this way, but because there are no other options, the supplier becomes the reluctant financier.

### **Recognize the Problem and the Impact**

The first step in any turnaround strategy is for senior management to recognize and acknowledge that there is a problem. Practicing “ostrich management” techniques will not fix the problem or make it go away. In fact, this will only make the problem worse. The second step is to confront the seriousness of the situation and to communicate beyond the senior management team. Senior managers often want to keep the financial distress a secret for as long as possible, when in reality vendors, as well as employees, are usually well aware that the company is in serious financial trouble.

Many things can tip-off vendors that there is a problem. Most obvious, outstanding bills take longer to be paid, the frequency of orders slows, contacts at the company avoid their phone calls or when they do speak to company contacts, the employees are acting cagey or complaining about the negative change in the working atmosphere. Because it is no secret that the company is having financial difficulties, transparent leadership is

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essential. The key to addressing a turnaround situation is to attack the problem, ignoring the urge to hide the truth. This means that the vendors, especially key vendors on which the company relies for daily operations, must be brought “into the fold” and included in the turnaround strategy.

### **Break Bad Habits**

Once management begins the process of confronting the situation, it is important to also start breaking bad habits they may have developed while trying to ignore the financial problem. This includes not responding to vendors’ calls for several weeks or months or keeping vendors in the dark about the issues the company faces.

Normal business practices will no longer work as these probably contributed to the company’s financial crisis. This includes inventory control, materials management, replenishment planning, procurement and purchasing functions. It’s critical for management to recognize that reliance on the traditional financial plan, budgets and prior policy will not support business during distress. Instead of relying on past procedures, the senior leadership team needs to develop internal cash controls to have a successful turnaround. This includes deferring purchases by substituting on-hand materials, converting overstock, obsolete and old material into cash and implementing or fine-tuning LEAN and JIT inventory management practices.

Business practices aren’t the only things that need an adjustment during a financial crisis. Management also needs to curtail exuberance and overly optimistic projections and adopt a more realistic outlook for the business. The company must not over-promise when negotiating with the vendor base, as no one likes surprises, especially negative surprises, when it comes to financial issues. Senior leaders must work to develop a cash-management plan that they are confident in presenting to the vendor base so they can successfully gain the necessary cooperation and support to achieve the turnaround. I often advise my clients to under-commit and over-perform, because failing to deliver on the terms of the turnaround plan will hurt the credibility of their management team, the viability of the turnaround plan and vendors’ willingness to continue to cooperate.

### **Communicate the Problem**

While every situation calls for a slightly different approach, one thing each successful strategy will have in common is direct and honest communication of the problem with the vendors. This means articulating a concise action plan, which will include informing the vendors that a turnaround team has been put in place and will explain how they will be affected going forward. It is only natural that suppliers will approach the conversation with some reluctance and reservation. But executives of distressed companies are often reassured and surprised to realize that after this initial, candid conversation (supported by credible, action-oriented details and messages), the suppliers are somewhat relieved to have an established turnaround team overseeing the checks and balances of the operation.

It is also a good strategy to appoint a primary contact within the organization to be the centralized communicator with the outside world — one person who can deliver a consistent, common message. This is where it may be helpful for companies to seek the advice and assistance of a third party, such as a restructuring consultant, that is able to independently assess the situation and become the sole point of contact for the supplier base. This practice minimizes misinterpretations and helps stabilize the situation while also providing a common denominator for all negotiations.

### **Recent Examples**

I was recently involved with two separate engagements in the Cleveland area that were illustrative of well-communicated turnarounds. Both companies utilized the strategy of writing a letter to all vendors, advising them of the current state of the company and the selection of our firm as the turnaround consultant. Simultaneously the purchasing manager and/or chief operating officer contacted all major vendors to discuss the announcement and offered a face-to-face meeting with the turnaround team. In both instances, the message was succinct, action-oriented and viewed as a positive development. Initially, the senior executives defaulted to a more comfortable style of trying to downplay the seriousness of the problems.

Our experience proves, however, that the vendors are more interested in knowing a well-developed plan is underway; it should be focused on the viability of the business and the management team’s commitment to making the necessary changes to fix it instead of making false assurances about the

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business. In both instances the senior executives experienced the positive benefits of transparency and now acknowledge that honest communication with their business partners is the *only* acceptable approach. A critical factor supporting the success of both turnarounds was developing and presenting a cash management action plan specifically detailing how and when the vendor was going to be paid. This gained the support and cooperation from the vendor base and was followed by regular communication updates to reassure them the company’s plan was on track.

The case of a local retailer facing possible bankruptcy is another example of a case I managed that demonstrates the power of communication. We requested the cooperation of the retailer’s vendors in the turnaround strategy. This included asking for their willingness to extend credit terms for the foreseeable future and to freeze existing trade debt. In most instances, we were able to establish long-term payment plans on the old debt (six or even 18 months in some cases) and maintain the retailer’s credit status for the upcoming busy retail season.

As bleak as the situation was, we communicated effectively to the suppliers that only by working together could we ever achieve a chance to pay off the existing debt and continue as a viable customer. The suppliers came to realize that “business-is-business” and trying to maintain an ongoing relationship was in everyone’s best interest. It would be almost impossible for their unsecured trade debts to be satisfied if they elected not to work with us. Our face-to-face meetings, letters and phone conversations explained the situation clearly and, more importantly, presented a way forward to rectify the situation in terms that they could easily understand.

### **Negotiating the Right Balance**

When a company asks vendors to stretch their terms and be more flexible on payments, as in the local retailer example, it must be prepared to negotiate and give something back in return. This is what makes supplier discussions an art, not a “check-the-box” tactic. If vendors are stretched too far, they will stop shipping

and could even threaten lawsuits or their own financial crisis. At the same time, if a company doesn't ask for enough leeway, it leaves money on the table that will negatively impact its cash flow. Even in distress, a company must strike a proper balance with suppliers to offer mutual benefit. The supplier must see a benefit in the plan for themselves to agree to the risks inherent in supporting a turnaround plan.

I often ask clients to consider it this way: vendors are one of the last sources of cash for a distressed company. Whenever a company negotiates additional time to pay, it has successfully borrowed an interest-free, permanent loan. If the terms are 30 days, a company might ask for 90 days, and if the vendor isn't willing to go that far, the two parties can try to meet in the middle at 60 days.

Although such requests may feel uncomfortable, executives need to negotiate honestly with vendors. It is imperative to be up front about why they require special terms and why they need their vendors' help. To most senior managers' surprise, a very high percentage of suppliers respond favorably to the request. Why? Because to them, their customers are a viable source of revenue and cash flow, and very few suppliers can afford to cut off their customers, especially those trying to work with them to pay off debt. Moreover, if the suppliers believe in the company's turnaround plan, then the allure of shared success and the prospect of continued growth can soothe any short-term anxieties.

As a distressed company continues communications and begins negotiations, it must be prepared to offer something in return for its vendors' patience and generosity. One relationship-building approach could include offering to purchase more product from vendors that support the distressed company through this difficult period, as evidenced through agreeing to aforementioned

conditions. As a further incentive, executives may want to consider offering to pay a certain percentage of the overall debt in the form of a late-payment fee so that the vendors are more comfortable serving as a financial cushion. Retailers, in particular, should consider providing marketing collateral for vendors willing to work with distressed companies. And of course, it is a best practice to plan to have a follow-up discussion to re-evaluate the financial situation and ensure that everyone is reasonably content with the arrangements and corrective action plans. If for some reason, a distressed company cannot pay as agreed, it is vitally important to proactively call the vendor, explaining the dilemma and the revised and improved corrective action.

While suppliers may not enjoy offering extended payment terms or providing additional product to a company that hasn't paid off past debts, they will appreciate the direct communication and being actively involved in the turnaround plan. They will also appreciate the promise of having a loyal customer once the distressed company survives its financial troubles. And in return, the distressed company will appreciate its vendors even more.

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