COVID Terms Pushback (Past Due and Pending POs), the Government Bailout and Customer Liquidity Crisis in a Financial Crisis: Credit Team Strategies

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COVID, through state shutdown orders, has caused severe financial strain on companies. Large swaths of manufacturing are closed as a result of COVID and may not reopen. As the government rolls out trillions of dollars to bailout companies, credit teams dealing with maturing and past due invoices are scrambling to determine whether their customers may qualify for government support.

In the face of this unprecedented economic downturn, customers are taking aggressive steps to preserve liquidity, improve their balance sheets and improve their cash position by pushing on the supply chain and unilaterally extending supplier's normal set terms to extended terms both for open invoices and pending POs. Customers are finding lenders pulling back on financing, and as a consequence are leaning on the supply chain to ease their liquidity crisis.

Credit teams are wrestling with customers both pushing out due dates of pending invoices and POs to extended terms. The customers' post-COVID supply chain strategy is to buy time and offload credit risk on the backs of suppliers through terms pushback as they await the economy to reopen. This new form of terms pushback, referred to as COVID Terms Pushback (CTPB), throws out metrics such as cash conversion cycle and days payable outstanding, focusing exclusively on preserving cash flow.

With forecasts estimating corporate defaults in the hundreds of billions of dollars, and headlines of an expected avalanche of Chapter 11s, what strategies may the credit team consider in order to reduce credit risk yet possibly preserve the credit terms relationship? All of this is new territory for the credit team, as we are only beginning to learn the long-term economic impact of COVID.

Federal Government Loans, the CARES ACT and Payroll Protection Program

In order to combat the economic difficulties and provide assistance to businesses, the Federal Government rolled out massive bailout and bridge loans as part of the Coronavirus Aid, Relief, and Economic Security Act (CARES). The $2 trillion relief package is aimed at helping state governments, education, small to big businesses, unemployed individuals, and the public health system. Large corporations, including airlines, are delegated $500 billion, while $377 billion is allocated for small to mid-sized businesses. Small businesses, however, are queued waiting to receive their loans despite facing difficulty in the eligibility and application process.

In the first two weeks that the Payroll Protection Program (PPP) was rolled out, one million loans valued at more than $240 billion were approved but proved lacking in funds as the Treasury followed with an additional $310 billion as replenishment. Many of the large public companies who received their PPP loans, however, were given 2 weeks to return relief loans in order to avoid scrutiny, since most of these retail stores and restaurants did not need these loans.

The CARES Act also added provisions to the Small Business Reorganization Act, increasing the debt limit to $7.5 million with no prohibition to access loans during a bankruptcy proceeding. Many however are finding it difficult to access the government's financing. A majority of the same businesses that have now grown accustomed to borrowing from lenders during the past decade since the 2008 recession, are now in debt with no solution, limiting their ability to borrow from banks or sell bonds. After companies bailed out under previous federal rescue packages, restrictions were placed in 2015 making bail out difficult and making the Federal Reserve reluctant in lending to insolvent borrowers. Those who have trouble meeting their financial obligations and paying debt when due are faced to find other financing.

Small-Sized + Mid-Sized $377 billion (additional $310 billion)		Large Corporations $500 billion
Less than 500 employees. Used for payroll costs, health care benefits, salaries, commissions, mortgage obligation, rent, and utilities.	From 500 to 10,000 employees. Must be used to retain at least 90% of the business' workforce, at full compensation and benefits, until September.	For airlines, businesses critical to maintaining national security, and lending facilities established by Federal Reserve.
Loans equal to 2.5x of average total monthly payroll costs, not to exceed $10 million.	Barred from paying dividends to shareholders for 1 year after loan is paid back.	Barred from paying dividends to shareholders for 1 year. Ban on stock buybacks for 1 year.
Interest rate at 4% Max maturity of 10 years	Interest rate at 2%.	Fund overseen by inspector general and panel.
Those that recently lay off workers required to repay portion of loan and no loan forgiveness. May not outsource or offshore jobs until 2 years after repayment.		Owners banned from receiving loans or investments.

While federal government funding may assist certain customers, the question for the credit team remains whether this funding makes a difference as a source to repay open invoices and to-be-released orders on terms or extended terms. The PPP is not a source to pay supplier debt. The government may be the source for companies to reopen or continue to operate, but these funds are not earmarked for payments to the supply chain.

The Supply Chain and Trade Credit

Supplier Credit as Driver in a Recession

In a recession, supplier credit can be key with assisting customers' working capital requirements. Absent supplier credit in this environment, customers face a cash flow drain as they are forced to pay suppliers for their goods and services in advance of the customer's sale of the finished product or service to the end user. In light of the economic collapse, traditional lenders are pulling back on their financing commitments to companies. As the companies negotiate with their lenders to continue financing, companies are racing for government funding.

The Origin of the Term Pushback Strategy (TPS)

The credit crunch of 2008 drastically changed customers' financing options. During that recession, many companies were unable to secure continued borrowing commitments from traditional lending sources, requiring these companies to turn to the supply chain for extended terms. Since then, many companies have adopted TPS as a best practice to improve their cash flow and working capital, as well as key metrics such as cash conversion cycle and days payable outstanding.

However, the COVID-driven financial crisis has changed the metrics motivating companies rolling out TPS, as noted. Companies losing their financing from traditional lending sources, and waiting for a government financing and conditional grant, are turning to suppliers to extend invoice due dates as well as unilaterally moving out supplier terms for pending POs as many of these companies await state shelter-at-home orders to be lifted and the economy to reopen.

CTPS and Credit Team Evaluation in a Recession

Know the Customer Post COVID

The credit team's assessment of a customer's ability to pay on terms, including extended terms, often involves evaluating a number of factors, including a complex scoring model and calling on various sources of financial, bank and trade data, along with internal searches. Post COVID, state stay-at-home orders and the shutdown of nonessential business has resulted in a large number of companies that were already struggling into insolvency. Companies that had a favorable credit rating may face a similar fate.

The credit team needs to re-evaluate the risk profile of customers by confirming whether customers provide an essential service under stay-at-home orders. Has the customer qualified for government funding through the CARES Act or PPP? Even if the customer receives emergency federal loans and grants, is that financing sufficient? Is the customer operating? If not, what financing is needed to resume operations? If operations are resumed, will operations be curtailed? Is the customer at risk of closing if another COVID wave strikes, and renewed stay-at-home orders causes another economic downturn? Is the customer susceptible to deflation? The challenge for the credit team is to determine when a customer's operations may resume to pre-COVID operations.

Invoices Past Due and Customer's Demand for Additional Time to Pay Given COVID Crisis

COVID Repayment Agreement

With those customers refusing to pay pending and past due invoices, consider marking these accounts' invoices as a "COVID balance". The credit team then rescores the customer based on the "Know the Customer" section. With meaningful "COVID balances", the credit team is better served to document these balances, rather than accept the customers' promises they will pay, especially given the credit terms request for pending POs. A repayment agreement gives credit teams protection with the "COVID balance", provided terms and conditions are included, such as:

- Fix the debt
- Fix the payment schedule
- Waiver of disputes
- Take collateral
- Clean up documents
- Guaranty, preference defense, favored supplier clause
- Fees, costs and venue
- Default, acceleration clause, stipulated judgment and confession of judgment
- Continued credit terms

Given the uncertainty surrounding the economic recovery period as a result of COVID, the terms and conditions contained in the COVID Repayment Agreement provide the credit team greater protections in the event of a default.

Robinson Patman Antitrust Evaluation

Given credit teams are evaluating the credit risk of customers and their ability to pay the COVID balance, the overlay of preferred terms by giving certain customers more time to pay a COVID balance under a COVID Repayment Agreement, may not be deemed a violation of the Robinson Patman anti-trust law. The credit team's evaluation of risk of non-payment is key to whether a repayment agreement is negotiated and what the duration will be. Given this credit risk evaluation, the credit team can freely select which customers will qualify for a repayment agreement and the duration, free from RPA scrutiny.

Supplier Strategy for Dealing with CTPS

Extended Terms Strategy - Credit Risk with Extended Terms

Post COVID, the credit team's focus of extended terms is no longer the impact on margins, but credit risk with the extended terms. The "Know the Customer" section is key to the evaluation, especially given the uncertainty as to a timetable for economic recovery.

Credit Enhancements

Given the economic uncertainty, the credit team should negotiate a credit enhancement, such as consignment, purchase money security interest, personal or corporate guaranties, deposit or credit insurance to offset the increased A/R risk with extended terms.

Supply Chain Finance

Supply Chain Finance is intended to improve a customer's payment terms, reduce costs and improve cash flow. It is structured so that a financial institution pays the supplier for the invoiced product or service, while the customers has until the invoice's due date to pay the financial institution. Supply Chain Finance Program transfers the risk of loss to the financial institution, as it is buying the supplier's receivable as part of the program. The credit team may use the Supply Chain Finance as risk mitigation, similar to a letter of credit or credit insurance.

Credit terms and Credit Line

What are the extended terms requested, along with an increased credit line?

Duration

What is the duration of the extended terms request? Is it for a limited number of orders to allow the customer to resume operations, or is it open ended?

Order size

If the extended terms request is for one invoice, is the order size large in relation to its reopening? The credit team wants to limit the risk of the customer loading up on inventory and closing its doors.

Two price lists

A higher second price list for extended terms, which takes into account the time value of money and credit risk.

Meet the Competition, RPA Exception

When the sales team shares that a customer is offered extended credit terms from a competitor, the credit team is asked to "meet the competition" with the same extended terms. If the supplier is acting to meet the extended terms offered to its customer by a competitor, then the supplier will not violate the RPA by agreeing to extended terms, even if those terms are more favorable than like-classed customers.

Next Steps for the Credit Team

As many customers try to resume operations and are looking for supplier support through additional time to pay pending invoices and extended terms for pending POs and new invoices, the credit team's leadership skills are more important than at any other time. The sales team has a less important voice today as a result of the recession and economic uncertainty. Rather, it is the credit team that needs to guide management through these turbulent economic times through an evaluation of the customer's ability to pay and prospects for a continued trade relationship.

About the Author

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