

Vetting the Viability of Vendors

By *Randy Myers*



Smart business owners wouldn't think of extending credit to new customers without checking into their finances and learning a little bit about their bill-paying histories.

Really smart business owners are just as careful about vetting their suppliers. A vendor who fails to deliver the goods or services you need to satisfy your own clients can be just as detrimental to your business as a customer who fails to pay you.

Englewood Construction Inc., a commercial contractor based in Schiller Park, Illinois, has spent the past few years honing its vetting protocol for vendors after learning firsthand the cost of getting burned by those who aren't able to hold up their end of a contractual bargain.

Founded in 2001, Englewood builds shopping malls, restaurants and commercial and industrial buildings across the country. Like many general contractors, it operates largely as a project manager, orchestrating the services of dozens of subcontractors who actually build its buildings. "We do not perform the actual construction work," says Chuck Taylor, Englewood's director of operations. "That is done by our subcontractors. They are our lifeblood."

Given that symbiotic relationship, it is important for Englewood to work with subcontractors who have the financial stability, manpower and expertise to deliver their services on time and on budget. Yet during its first several years of operation, Englewood suffered through as many as a half-dozen instances annually in which subcontractors failed to perform. In one case, Taylor recalls, an electrical subcontractor went out of business mid-project, forcing Englewood to pay \$25,000 to the subcontractor's supply house for materials Englewood had already purchased from the electrician. It also had to spend an extra \$20,000 to bring in the next-lowest-bidding electrician to finish the work.

Today, before issuing a contract to a subcontractor, Englewood typically asks it for a recent bank statement showing, among other things, the size of the subcontractor's credit line. It asks for references from other general contractors for whom the subcontractor has done work, and for documentation of its bonding capacity. It asks about the subcontractor's "experience modification rate" — a metric that measures its annual insurance claims relative to its insurance premiums. A lower rate tends to reflect a better-run company. Finally, Englewood purchases a credit report on the subcontractor from Dun & Bradstreet.

The results of this vetting protocol have been impressive. Last year, Taylor says, Englewood had only one subcontractor fail, and it caught wind of the problem in time to stop payments to the company and find an alternate subcontractor that could finish the job on schedule.

As is the case when checking the creditworthiness of new customers, it makes sense to apply some discretion when deciding which vendors warrant a full-scale vetting. You might forego the process for a vendor supplying goods or services that you could easily secure elsewhere on short notice — office supplies, for example. By contrast, you'll want to be extra careful qualifying the vendor who sources, say, hard-to-find materials or custom-made components for products you manufacture.

"It comes down to a judgment call," says John Campi, managing partner of consulting firm Genesis Management LLC in Marietta, Georgia, and a former procurement officer and supply chain guru for several Fortune 500 firms, including Chrysler, the Home Depot and DuPont. "How critical are they to your business, how commonly available is their product or service, and what would it cost you to switch to another vendor?"

When a vendor is very critical, Campi suggests, you'll want to assess its financial stability, operational and shipping reliability, and, in some cases, even the stability and reliability of its suppliers. That can involve making personal visits to those businesses, asking for copies of their financial statements, purchasing credit reports on them from Dun & Bradstreet or some other reliable credit agency, and contacting their other customers for real-world feedback on their performance.

If a vendor's failure would be catastrophic to your business, Campi suggests lining up a second source for the goods or services it provides. You might give 20 or 30 percent of your business to the alternate vendor, even if it costs you more money in the short run. The trade-off is having that source readily available if you ever need it in a pinch.

Beyond parsing numbers, Campi says it can be helpful to develop personal relationships with your vendors. That can pay dividends when emergencies crop up and you need supplies or services in a hurry, or if a supplier starts to fall on hard times.

TPGTEX Label Solutions Inc., a Houston-based seller of label-printing software, printers and related products, got a head start on finding a new printer supplier a couple of years ago after a friendly sales representative, without going into too much detail, warned that the company's existing vendor was on rocky footing. Within a month, the vendor had shut its doors, but by then TPGTEX was already well on its way toward lining up a new supplier.

"When we call a vendor to place an order, we always chitchat," says Orit Pennington, co-owner and chief financial officer of TPGTEX. "We get more valuable information than you can imagine. We also make a point to talk to our vendors' technical people, so that we know what the knowledge base is behind their products."

If you've been lax in vetting your vendors, take time soon to figure out which are most critical to your organization and how you'd recover if they were suddenly unable to meet your needs. Do what you can to verify their financial and operational health — and when the risk of failure is too great, get to work lining up a second source for the goods and services you need. Do this now, and you'll lessen the odds of your supplier's next crisis becoming your crisis, too.

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