collective wisdom®

SZABO ASSOCIATES, INC. VOLUME 24, ISSUE 2, JUNE 30, 2009

Dear Friends:

As if the advertising sales environment were not tough enough these days, media are now receiving notices from advertisers demanding longer payment terms! While some media properties are saying "no" to these demands, many feel they are offers they can't refuse. In this issue's feature article, we talk about the consequences media should weigh before making this important decision.

At the MFM/BCCA Annual Conference in May, we were pleased to present the 2009 Peter F. Szabo Career Achievement Award to Connie Allcorn, Business Manager of WSB-TV. The award, established in memory of our founder, Pete, recognizes Connie for her many contributions to the organization and the industries it serves.

On our summer calendar are the Szabo Quality Awards Banquet, August 3 in Atlanta; the New Mexico Broadcasters Association, August 14-15 in Albuquerque, New Mexico, where I will be a session speaker on credit and collections; the MIXX Conference, September 21-22 in New York, New York; and the National Association of Broadcasters (NAB) Radio Show, September 23-24 in Philadelphia, Pennsylvania.

Best wishes for a great summer,

Robin

Robin Szabo, President
Szabo Associates, Inc.

When Customers Dictate Payment Terms ... Consider All Consequences!

In a letter dated February 5, 2009, Anheuser-Busch advised its vendors that it had changed its corporate policy governing payment terms. Effective March 1, media supplier invoices would be subject to net 120 days. Media suppliers were instructed to notify the company if they were unable to conduct business on these revised terms, and failure to reply would be interpreted as an agreement to the new terms. The letter concluded with the company's assertion that the new terms are consistent with standards used by other multinational companies along with the admonition that "if you are not able to work with the change in payment terms, we may have to consider an alternative supplier."

Last year, General Motors, historically one of the U.S.'s biggest purchasers of advertising, asked advertising agencies to cut their fees as much as 20% for 2008 and 2009. The automaker is now pressuring media to accept 70-day payment terms. GM has suggested that it is seeking a few "preferred vendors" and that inclusion on the list requires agreement to its new terms.

The current downturn is far-reaching, with businesses in virtually every sector of the economy feeling its impact and trying to minimize losses by any means possible. More and more companies are now asking their suppliers, who themselves may be struggling to get credit and stay afloat, to bear the burden of their credit woes by accepting longer payment terms. Some of these suppliers have little recourse except to demand the same considerations from their own suppliers, who then feel compelled to make similar demands of their suppliers, and so on and so on.

Payment terms, by definition, are "conditions under which a *seller* will make a sale." These terms generally specify the time period allowed by the seller to the buyer to pay off the amount due. While "cash in advance" is often the term of choice for marginal or delinquent accounts, "net 15" or "net 30" are the generally accepted terms of payment in the media industry. In a legal context, net 30 means that the buyer will pay the seller *in full* on or before the 30th calendar day (including weekends and holidays) from when goods were dispatched by the seller or services were fully provided.

If "terms," according to definition, are set by the seller, what does it mean when some of the biggest advertisers in the country are pushing their suppliers to the wall, making demands for terms that not only would have been considered totally unacceptable in past times but are being accepted by many media properties without push-back or further negotiation? These recent moves by advertisers to dictate payment terms to media portend a troubling trend, in which media's payment terms become a negotiable item based upon the health or weakness of the economy, the size and clout

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of the customer, and media's need to sustain sales revenue through good and bad times.

While some media suppliers are just saying "no" to buyers' demands for longer payment terms, many are reluctantly accepting them. In these difficult economic times, many media properties feel that they cannot afford to turn down business, especially from large customers. They believe that if they do not accept the terms, other media properties will, and the customer will be lost now and perhaps forever. Choosing to accept business on buyers' terms is understandable in this economic climate; however, it is wise to evaluate the reasons for the demands and both the short-term and long-term consequences of accepting them before making the decision to do so.

Why are buyers dictating payment terms?

While a particular event, such as the Anheuser-Busch/InBev merger, can trigger the policy change, advertisers are generally seeking to compensate for their own lack of available credit by demanding that media give them what are essentially no-interest loans. By treating suppliers as banks, advertisers can defer liabilities to a future quarter, improving their current revenue to expense ratios, and use the interest on the float to pay down their own debt.

In the case of AB InBev, the new contract terms are part of a cost-cutting effort to help pay for the $52 billion purchase last year of Anheuser-Busch by the Belgian company InBev. By aligning its payments to suppliers with incoming cash from sales, the company can free up hundreds of millions of dollars in working capital and thus reduce its need for expensive short-term financing. Anheuser-Busch is also experiencing a shift in corporate culture, its generous spending practices and employee perks being replaced by a bare-bones culture focused on cutting costs and increasing profit margins. The company's longtime relationships with advertising agencies, sports teams, and media have not escaped InBev's critical eye with regard to cost savings, with significant cutbacks in ad production and placement in addition to fee cuts and longer payment terms.

It comes as no surprise that a cash-strapped car manufacturer, which now has filed for bankruptcy, would try to extend suppliers' payment terms. A General Motors spokesperson said the changes were made to help the company operate more efficiently and transition to "new realities."

What will acceptance of longer payment terms cost our company?

Accounts receivable represent money loaned to the customer, money that is unavailable to pay your own obligations until it is received by the customer. While reasonable payment terms are a necessary part of doing business, the longer a customer takes to pay, the more value the money has for the customer, and the less value it has for you. If you have to borrow money in order to keep your operations going while you wait an additional 90 days or more to get paid by the customer, you must pay interest on the loan while the customer continues to use your money, interest-free.

Ask yourself the the following questions: Can we afford to give this customer X number of dollars, interest-free, for an additional three months? Will a customer who asks for net 120 payment terms pay promptly at 120 days? If a company has a history of paying at 90+ days after having agreed to net 30 terms, how long will it take them to pay if they get us to accept 120-day payment terms? Will they now perceive that they can pay 60+ days after the 120-day term expires without any push-back?

What impact will acceptance of longer payment terms with some customers have on our customers who pay according to our usual terms?

How will you respond if a good customer calls and says, "Why should we have to pay net 30 when this other company gets special 120-day privileges"? Will you respond by saying, "We can't afford to lose their $100,000 per year account"? While payment terms for a particular customer do not have to be public knowledge, such information on high-profile advertisers such as AB InBev and General Motors is easy to come by in trade and business publications.

How will acceptance of longer payment terms affect our ability to collect if the company goes bankrupt?

A demand for longer payment terms can be a sign of a troubled customer along with increased risk that bankruptcy is on the horizon. By meeting the company's request for longer payment terms, the time frame for exposure to that risk is extended. If you agree to 120-day payment terms, you immediately place four months of consecutive billing at risk of nonpayment. As unsecured creditors of the bankrupt company, media would receive payment on a pro rata basis only after administrative expenses and other priority claims are paid.

An additional risk in a case of bankruptcy is the impact of altered payment terms on preference actions. An essential element that defines a payment as a preference is that the payment was made on or within 90 days before the Bankruptcy Petition. If media receives payment on March 30, net 120 days from its November 1 invoice, and the debtor files for bankruptcy on April 1, the payment could be subject to a preference action. Even though the invoice was dated and sent well before the preference period began, the money was received within the 90-day period prior to the bankruptcy filing date.

If the payment is subject to a preference action, the preference defense would probably be that the payment was made in "the ordinary course of business." If, however, the payment terms were extended beyond media's usual terms, could this defense hold? Prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), creditors wishing to successfully defend a payment with this defense had to show "… that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee; made in the ordinary course of business or financial affairs of the debtor and the transferee; *and* made according to ordinary business terms." BAPCPA modified the requirements, allowing preference defendants to more easily pursue the defense. Now, the exception will be satisfied when the transfer is a payment made in the ordinary course of business of both the debtor and transferee *or* when it is a payment made according to ordinary business terms. (The transfer still must be one for a debt incurred in the ordinary course of business for both the debtor and the transferee.) (See *Collective Wisdom*, September 2008.)

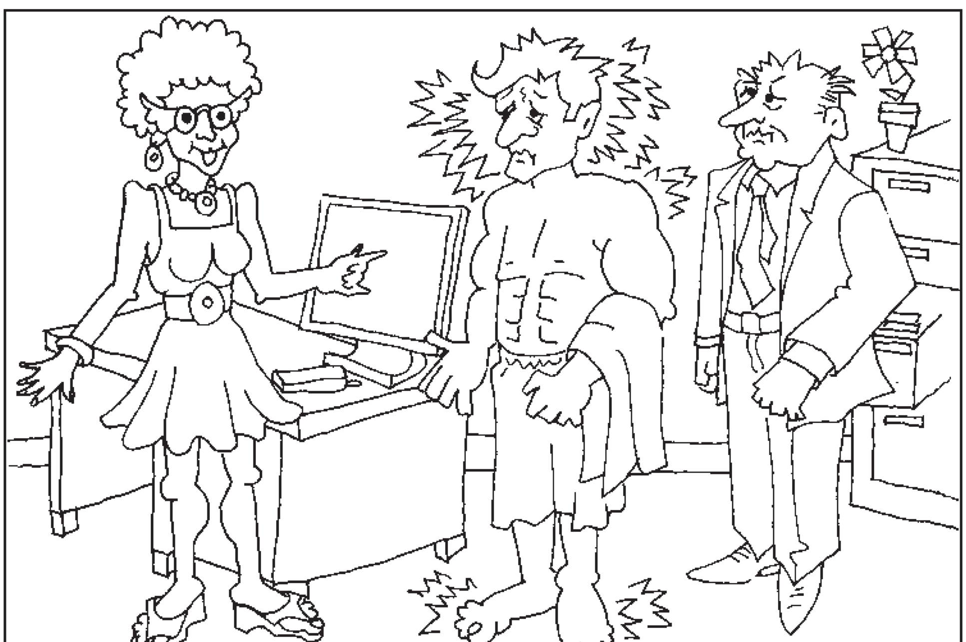
If a media supplier agrees to longer payment terms, the best choice would probably be to satisfy the second alternative. The court heard such a case, in which a long-time advertiser on the creditor's radio stations consistently paid invoices between 90 and 120 days, while other advertisers usually paid between 60 and 90 days. The debtor's payment terms were 30 days; however, the creditor agreed to change the troubled debtor's terms to 90 days, and the debtor began remitting post-dated checks. The debtor filed Chapter 7, and the trustee demanded the return of payments within 90 days of filing. The court held that the creditor was allowed some latitude with regard to the industry standard because of the long-standing relationship with the debtor, and that the timing and method of payment were within the "sliding scale" window of industry standards. (See *Collective Wisdom*, December 2004.)

If you decide to accept longer payment terms, it is advisable to put the revised terms in writing. If the customer files for bankruptcy, the document would help establish that the terms were changed only to accommodate a good customer during tough times.

If we accept longer payment terms, will we be able to revert to our usual terms when the economy improves?

Once customers get "one heck of a deal" on payment terms, chances are that they will not call you up one day and say, "Things are so much better now that we will gladly send you payment in net 30, just as before." A great deal is a great deal in good times as well as bad, and most customers will continue to accept your largess as long as you allow them to. Knowing that you will have to confront this aspect of human nature in the (hopefully) near future, you should consider the circumstances that prompted the customer to make the demand in the first place, then decide prior to acceptance how you will manage reverting to your previous terms.

One approach might be to agree to the longer payment terms for a fixed time period, perhaps 12 months, with the option of renewing the terms at the end of the time period or reverting to your original terms. Alternatively, you could agree to longer terms with the caveat



"Mr. Jones said if we could just this one time change his payment terms to net 120, we could get three months of unlimited tanning services at any of his ten convenient metro locations."

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that the agreement be subject to renegotiation at any time with a specified notification period.

Of course, some companies will regard the new terms as permanent. If the demand comes as a result of the company's incurring a huge debt burden, or if it is viewed as being consistent with the way others in its industry conduct business, chances are that renegotiation will be difficult or impossible.

What are the consequences of refusing to accept longer payment terms?

If you refuse to adjust your payment terms, you may indeed lose the customer, perhaps permanently. Advertisers such as AB InBev have made it clear that suppliers who refuse to accept net 120-day payment terms will probably lose their business. Other advertisers, fearful of losing their ability to get credit in the future, may simply be trying to hang on to as much cash as possible without any intention of pulling their business from you.

A customer's request for longer payment terms does not always have to become a "zero-sum" game. Rather, it can present an opportunity to strengthen your relationship with customers by expressing your understanding of their financial challenges and by considering options together.

Try to determine the reason for the request for longer payment terms. Is it a relatively short-term problem because of the recession? Does it represent a cultural shift within the company? Is the customer at risk for bankruptcy? If you decide to extend payment terms, make it clear that the agreed upon terms include no "wiggle room" for even a one-day delinquency. Decide upfront on a date for renegotiation. Reiterate the terms in writing. If the terms are net 120 and the check is not received on time, call the customer on day 121.

It is unfortunate and unfair that media are being forced to choose between losing business or losing revenue with longer-than-reasonable payment terms. When the recession ends and sales conditions improve, it may be a worthwhile exercise to examine the behaviors of both media and their customers. The knowledge gained from this long and severe recession should be valuable when media are faced with such challenges in the future. ♦

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