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Chimes Demise Is A Wake-Up Call To Staffing Firms

By **James Rothman**

The trend in the staffing industry over the last few years has been an increase in the use of vendor management services (VMS), typically by Fortune 100 companies. Although the Ensemble Chimes Global Chapter 7 filing under the bankruptcy code has resulted in several surprises (mainly appearing to benefit the subcontractors who provide services through the VMS), it is also a wake-up call for the staffing industry.

COURSE OF DEALING

Although contracts between the VMS and their subcontractors sometimes had specific payment terms, the typical payment terms were that the VMS would make payment to the subcontractor when paid by the end user. This was often necessary since the management fee earned by the VMS was frequently in the single digits in terms of gross profit. What's more, the cost of funds for paying these receivables earlier than when they were paid by the end user would drain away the thin profit spread for the VMS.

The spread taken by the VMS often came out of the margin enjoyed by the service provider. So staffing companies were not only potentially taking credit risk, they did so at lower gross profit. This appears to be the general case with Chimes. Wise staffing companies then had to evaluate the credit worthiness of not only the end user, but also the VMS since there was credit risk from both parties based on this course of dealing. If a weak end user defaulted, often the VMS would not make payment to the subcontractor. This was especially prevalent in the IT markets in 2001 and 2002. Many staffing companies took credit losses in that era due to the multiple layers of subcontractors and the lack of diligence on credit risk.

This time around, most staffing companies only took risk from one level away from the end user, the

VMS. The difficulty is that many of these VMS's were privately held companies and would not release financial information to allow their vendors to assess credit risk – a high-risk proposition for any unsecured creditor.

THE FALL and the FALLOUT

Many staffing companies were blindsided by the Chimes collapse similar to the collapse of Kmart and Enron in years prior. These bankruptcies had a profound affect on their industries, and in fact, the stock market as a whole. At first, the collapse looked like a sizable disaster for the staffing industry with the potential for multiple insolvencies as speculation mounted that the Chimes receivables would be tied up for years in the bankruptcy court. As far it appears as of the writing of this article, the industry may have dodged a bullet.

A WHITE KNIGHT?

The buyer of the Chimes assets, The MPS Group, Inc., seems to be a white knight. As part of the purchase, they insisted that the value of Chimes would be nil unless the "critical vendors" (the staffing company subcontractors) were protected. As a result, the court ruled that the receivables due from the end users could be paid directly to the subcontracting staffing companies. In essence, the subcontractors became a class of critical vendors that had payment priority over other non-critical vendors.

However, there were several objections raised to the court on this order, making it subject to appeal. Thankfully, no appeal was filed and the payments made by the end users to the service providers were approved by the court. If an appeal had been successful, the payments made by the end users to the subcontractors could have potentially been disgorged and all the money received by the staffing companies might have been returned to the trustee in

bankruptcy. That would put us back into a worse case scenario, where staffing companies could have borne the brunt of the credit risk from the Chimes insolvency.

How this bankruptcy will affect the relationship between the end user and the subcontractor is going to depend on how this plays out. Many end users are going back to direct payment to the actual supplier of services. Some vendor managers may become more of a clearing house rather than a "staffing supplier." Other staffing companies are requiring greater scrutiny of the credit worthiness of the VMS, insisting on financial disclosure. Some vendor management services have opened up their books to large lenders like Capital TempFunds to ensure proper granting of credit commensurate with financial stability.

LESSONS LEARNED

What can staffing companies learn from the Chimes flameout?

Know what your true selling terms are.

Know your credit risk at all levels.

Price your services properly.

Whenever possible, get a guarantee from the end user for payment of services provided that were not paid to the VMS. (The VMS can structure an indemnification so they have a mechanism for offset.)

As you prepare to rise above uncertain times and take hold of opportunities to capture new business and build profits, count your blessings that this potential industry disaster appears to have been averted. However, let's be forewarned that the next time this happens, we may not be so lucky. ■

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