



## 10 Early Warning Signs of Financial Distress

- 1 Cash Flow, Cash Flow, Cash Flow:** This information is revealed in the cash flow statements. When cash payments exceed cash income, the company's cash flow is negative. If cash flow stays negative over a sustained period, it's a signal that its cash could be running low and is insufficient to cover bills and other obligations. So keep an eye on changes in the company's cash position on the balance sheet.
- 2 Forbearance:** A sign of trouble for a company is needing forbearance on payment of their indebtedness. Be aware of this when they call and ask, and if you are able to get industry information, pay close attention to it. Listen to the credit reporting agencies and the information that they provide so that you avoid or minimize uncollectable accounts.
- 3 Delays in Collecting Receivables:** This is another early sign of trouble. If this occurs and is sustained over a period of time, it is a sure sign of trouble both for your company and perhaps for your company's industry.
- 4 Accounting Personnel and Other Employee Defections:** A real sign of trouble is when a company's accounting personnel are leaving and/or when other important personnel are leaving generally.
- 5 Trouble with the Bank:** The Bank is reducing borrowing availability, or declaring non-monetary defaults, such as covenant defaults.
- 6 Customer Concentration or Customer Loss:** If a customer is 8% or more of a company's sales, the company has a customer concentration problem. Customer loss is another indicator of financial distress.
- 7 Increasing Necessity to Put in Additional Capital:** As sales decline and/or borrowing availability under credit lines decreases, company Principals are required to loan more money in order to bridge revenue shortages and payment of operating expenses.
- 8 Sales Growth Declining or Sales are Stagnant:** Sales growth is a constant pressure to any business. Where sales growth is declining from historical norms or sales are stagnant for a period of time, this is a sign of financial distress.
- 9 Renewal Sales, Inbound Leads, or Other Metrics Are Flat-Lining:** Even before sales decline, new sales leads start to decline. This can be a particular sign of financial distress.
- 10 Falling Profit Margins:** As you chase sales, you find your company selling its product for less in order to achieve target sales volume. These sales are an illusion. If you are not achieving requisite gross profitability on your sales, presuming your sales costs and other overhead remain stable, you're either going to lose money or not realize needed profitability.