

Financially-Challenged Manufacturers Can Create Unexpected Risks for Dealers

The farm equipment industry has been riding a wave of strong farm income over the last several years, leading to positive results for most in the industry. But with commodity prices falling, relatively high used inventory levels, and reduced sales forecasts by suppliers, you need to be aware of some of the unexpected risks that are more likely to pop up in your relationships with suppliers during a potential downturn. One category of risk that is often overlooked relates to the inventory you obtain from suppliers experiencing financial difficulties. These situations typically arise with your short line suppliers. While many short line suppliers are very well run and have been great partners with dealers, we see more risk in these relationships for three primary reasons: (i) a limited product line can make a supplier more susceptible in a downturn; (ii) short line suppliers often sell equipment to dealers using a third party floor plan program (see first bullet point below for more information on this risk); and (iii) it is more difficult for you to determine the financial strength (or weakness) of a smaller, privately-owned supplier. The following is a list of some of inventory-related risks that we see for dealers:

- Storing Inventory on Your Lot. Suppliers will ask dealers to temporarily put inventory on the dealer's lot. This often occurs when another dealer is selling or closing out. If you accept the inventory with the understanding that you are not taking ownership, you need to monitor your floor plan statement very carefully to make sure that the inventory does not appear. If it does appear on your statement, your floor plan lender will often have a legal claim against you for this amount, regardless of the deal that you think you have with the supplier. This situation can occur because agreements in supplier-sponsored floor plans often say that inventory can be placed on your statement through a communication from the supplier. To help limit your risk in these situations, be sure to document in writing with the supplier that you are not taking ownership of the inventory and that the supplier is not authorized to put it on your floor plan. You should also immediately send a written notice to your floor plan provider informing it of the improper charge.
- Transfers from Other Dealers. When dealers sell or close a location, suppliers frequently try to move inventory to another dealer to avoid taking it back on their books. If you are accepting a transfer in this situation, you should make sure that there is written documentation showing the transfer of inventory from the supplier to you. This is important because the buy-back laws generally require suppliers to repurchase only inventory that was purchased from the supplier. As a result, if your transfer documentation indicates that you purchased the inventory from the other dealer, a supplier may try to use this to get out of complying with a buy-back obligation if you later decide to terminate the dealer agreement.
- Buy-Back Compliance. A supplier in financial trouble may refuse to comply with the buy-back obligations under the dealer protection laws. Unfortunately, the refusal by the supplier will not get you off the hook with your third party floor plan lender. The prospect of immediately re-paying the floor plan lender when combined with the obvious challenges of trying to sell off inventory produced by a defunct supplier can jeopardize the financial standing of otherwise solid dealer organizations.
- Prepaying for Inventory. Some manufacturers require dealers to pay cash for inventory before it is produced. Dealers often elect to do this in exchange for discounts in the price. However, you should proceed with caution when taking this approach because your prepayment is the equivalent of an unsecured loan. This means that if a manufacturer goes under before you receive your order, there is very little chance of being repaid.

The sky is definitely not falling. But it will pay for you to be aware of these risks in times that may get a

bit challenging for you and your suppliers. Although you can't eliminate risk in your business, being aware of the potential landmines will put you in a better chance to reduce your exposure.